

BUSINESS INCENTIVES IN THE 2010 HIRE ACT

This year, Congress passed and the President signed the Hiring Incentives to Restore Employment Act of 2010 (2010 HIRE Act). The 2010 HIRE Act has several business-friendly tax provisions that may benefit you, three of which are explained here. The Act encourages employers to hire new employees in 2010 by granting Social Security tax forgiveness for newly added qualified employees and allowing a tax credit for retaining those employees for at least 52 consecutive weeks.

PAYROLL TAX FORGIVENESS

The 2010 Hire Act effectively exempts a qualified employer from paying the 6.2% OASDI Social Security tax for wages paid for any 2010 period beginning after March 18, 2010 (the date of enactment) through December 31, 2010, for new employees if certain conditions are met. To qualify for the exemption, each employee must be a qualified individual.

A qualified individual is an employee who:

- begins work for a qualified employer after February 3, 2010, and before January 1, 2011;
- has not been employed for more than 40 hours during the 60-day period ending on the date employment begins; (Form W-11 is required)
- is not employed to replace another employee of the employer unless the other employee separated from employment voluntarily or for cause; and
- cannot be related to the employer or own more than 50% of the business.

Generally, a qualified employer is any business, other than a governmental entity. A qualified employer may elect not to apply the payroll tax forgiveness. It should be noted that a qualified employer may not claim the work opportunity tax credit on any wages paid to a qualified individual during the 1-year period beginning on the hiring date of the employee if those wages qualify the employer for payroll tax forgiveness, unless the employer opts out of payroll tax forgiveness as to that employee. The reduction in taxes due for wages paid in the first calendar quarter of 2010 is treated as a payment against the second 2010 calendar quarter taxes otherwise due.

To claim the payroll tax exemption, the new employee is required to certify by signed affidavit that he or she was employed for 40 hours or less in the 60 days prior to the beginning of the present employment. IRS Form W-11 is required to document the qualified employee.

MORROW & CO.
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PERSONAL SERVICE TO OUR CLIENTS



BUSINESS TAX CREDIT FOR RETENTION OF NEWLY HIRED INDIVIDUALS IN 2010

The 2010 HIRE Act allows taxpayers a tax credit by the lesser of \$1,000 or 6.2% of wages for a 52-week period for each retained worker that satisfies a minimum employment period. A retained worker is defined the same as a qualified individual for purposes of the payroll tax forgiveness provision, which is discussed above. In addition, the worker must be employed by the employer for at least 52 consecutive weeks, and receive wages for the last 26 weeks of the 52-week period that are at least 80% of the wages paid during the first 26 weeks. This tax credit is effective for new hires beginning on March 18, 2010, and cannot be carried back to a taxable year that began prior to this effective date. Note that employers can claim both the work opportunity tax credit and the retention credit on the same qualified employee.

If we assist with your payroll tax filings, please notify us of any newly hired employees that qualify for these incentives.

ELECTION TO EXPENSE DEPRECIABLE BUSINESS ASSETS

The 2010 HIRE Act extends the higher \$250,000 limit for small business expensing for another year. The \$250,000 amount applies to the cost of depreciable tangible personal property purchased for use in the active conduct of a trade or business (including off-the-shelf computer software placed in service before 2011) for taxable years beginning in 2010. This \$250,000 amount is reduced, however, by the amount by which the cost of the qualifying property placed in service during 2010 exceeds \$800,000. Note that the deduction amount continues to be limited to the taxpayer's taxable income derived from the active conduct of the trade or business. Any amount that exceeds the taxable income limitation may be carried forward to succeeding taxable years.

REMINDERS

ENERGY CREDITS

In the January 2010 issue, we presented information on residential energy credits, which we now believe will be allowed to expire at the end of 2010. These credits can be attractive to those of you who are thinking of replacing windows, or making other improvements to improve energy efficiency. The January 2010 issue is on our website, and we invite you to re-read it.

SECTION 179

Also, we remind you that the liberal code SEC 79 deductions are set to expire at the end of 2010. The expensing limit of \$250,000 is set to drop to \$125,000.

CAPITAL GAINS

Capital Gains - Rates are scheduled to increase in 2011. Without Congressional action, capital gains rates will revert to rates in effect prior to 2003. This means the 15% rate goes to 20%, there will again be an 18% rate for gains on assets held over 5 years, and dividends will be taxed at ordinary rates.

HOMEBUYER CREDITS

Homebuyer Credits - We had told you that to qualify for the long time homebuyer's credit that the contract for your replacement home needed to be dated before May 1, 2010 and closing had to occur before June 30, 2010. Due to delays caused by banking requirements and a backlog at title companies, the June 30 date has been extended to September 30. So, if you had given up on being able to qualify due to this date, you should give us a call.

OTHER CHANGES

Tax and business planning becomes even more important in these turbulent times. Tax laws changes at the Federal and State levels are a part of the turbulence, but also, it seems that we are all being buffeted by other changes that affect us as well. As an example, we are seeing banks issue policies where they will no longer accept paper payroll tax deposits causing those affected to find new procedures to comply with the law.

IRS policy is aimed at more dependence on electronic filing of various taxes, and a greater reliance on information reporting in order to force more taxpayers to report their income. The result is that businesses will do more work in information reporting, and be subject to more penalties for noncompliance, even if that noncompliance is inadvertent. We aren't certain what Kansas policy is--but requirements for electronic filing seem ahead of their capabilities, and the quest for additional revenue seems to be ahead of the law at times.

Some of this is frustrating for you and for us. Just remember that we are still committed to keeping things as simple as possible for you. All the while, trying to help you keep your tax burden as low as the law allows. Call us to help with your concerns and ideas.

KANSAS SALES TAX

The recent increase in Kansas sales tax rates caused cash registers to be re-programmed and heightened considerations to those with contracts in place. Now that those immediate concerns are out of the way, businesses need to heighten their awareness and re-examine their policies regarding sales tax compliance. The stakes just got higher. Sales tax audits may be dreaded even more than income tax audits. Auditors generally like to audit a period and extrapolate those results to the period open by statutes, which is generally four years. Results can be staggering.



The State rate increase from 5.3% to 6.3% along with continuing new county and city sales taxes show that this tax provides a convenient source for new revenues. It continues to be a tax that is difficult for businesses to administer. It is complicated by what is taxable and what is exempt as well as what rate to apply to a destination based tax where rates can vary depending on the city limit boundary.

KANSAS CHANGES

Effective September 30, 2010, Kansas will no longer provide paper sales tax returns, compensating use tax returns, nor Kansas withholding tax returns. This is to comply with the legal requirement to submit these returns electronically. The law is to take effect July 1, but apparently KDOR is allowing an administrative delay until September 30.

We have been working with clients to implement new procedures to comply with this requirement as well as incorporate electronic solutions for federal payments. One of those solutions has been a dedicated computer at the reception desk where taxpayers can make their electronic filings and payments. In a departure from past procedures, we are also now making electronic payments for clients on their behalf.

If you have not yet implemented procedures to comply, or if you don't like the procedure that you are using, make sure you give us a call. We are committed to making this work.





LONG TERM STRATEGIES

We believe that the Federal policies will turn from one of deficit spending to stimulate the economy to one of increasing taxes to pay for all of this. We are less certain of the timing.

We believe that Kansas and local governments will also be more fiscally responsible in light of the woes of California and some cities. More than likely it will be easier to raise taxes than to reduce services and cut expenditures.

These beliefs lead us to believe that 2010 may be the year to reverse traditional tax planning.

Traditional tax planning has been to delay income and accelerate expenses in order to minimize this years tax at the expense of next years tax. The result was that we had this ball of deferred taxes that we were forever pushing ahead of us.

More specifically, if you plan to sell a business, or a rental property, or a piece of land, or stocks with large gains---then you may want to accelerate your plan. Capital gains rates of 15% seem destined to go up in 2011. These transactions cry for tax planning. The alternative minimum income tax often creates unexpected results without

planning. The complexities of the law make planning difficult for all of us, but, being somewhat informed is better than not being at all informed. Call us so we can assist you by preparing tax projection scenarios.

There will be more and more elderly people in relation to the number of people working. This will create continuing stress in that we have more people drawing from the system in relation to the people paying into the system. The effects will be visible in the social security system, the pension system, and the health care system. It may well affect securities and land prices if there are fewer investment dollars available.

We have seen the first actions to cope with this where net investment income will suffer a 3.8% medicare tax starting in 2013. (See Health Care Reform Act in this issue). It seems reasonable that more actions can be expected to follow. More taxation from IRAs, 401ks, and pension distributions would make likely targets due to the magnitude of those funds.

Our advice in this respect is to continue to fund your retirement plans, but also be building funds on an after tax basis that is not a retirement fund.



PATIENT PROTECTION & AFFORDABLE CARE ACT OF 2010 (Health Care Reform Act)

President Obama signed into law the Patient Protection and Affordable Care Act on March 23, 2010. The Act (and the subsequent Health Care and Education Reconciliation Act amendment) applies to group health plans and, in some instances, self-funded or self-insured plans. The law imposes penalties (effective 2014) on certain employers that do not provide minimum essential health benefits to full-time employees and requires most individuals to maintain health care coverage. The new law also includes an additional Medicare tax on wages and

self-employment income of higher income tax payers.

Although the bulk of the legislation does not take effect until the 2013-14 timeframe, we want to bring to your attention several of the tax provisions that might affect your 2010 and 2011 federal income tax liability and reporting requirements. The following identifies the significant tax-related elements of the new law and the year in which each provision will be in effect:

2010

- For taxable years beginning in 2010 through 2013, a small business may qualify for a tax credit for up to 35% of their contribution toward the employee's health insurance (Note: In 2014, the eligible tax credit will increase to 50% of contributions).
 - To be eligible for the tax credit, the employer must contribute at least 50% of the total per employee premium cost of an employer-offered qualified health plan (Note: Premiums paid will count for all of 2010 even though the bill was recently passed).
 - The employer percentage paid does not have to be uniform (e.g., employer can pay 50% of premiums for one employee and 100% of another).
 - Any premiums paid pursuant to Internal Revenue Code SEC 125 (salary reduction arrangement) is not eligible for this credit.
 - The tax credit reduces the employers deduction for health premiums paid.
 - The amount of the tax credit is the lesser of:
 - the amount of premiums paid on behalf of employees times the applicable percentage; or,
 - the amount of premiums that would have been paid if each employee had enrolled at a benchmark premium times the applicable percentage (Note: The benchmark premium will be based on a state-wide average and will be established by the IRS).
 - Employers with up to 10 full-time equivalent (FTE)

employees and average annual wages less than \$25,000 will be eligible for the full 35% credit (Note: This credit is reduced for employers with 11 to 24 employees and average wages of \$25,000 to \$50,000) (Note: In 2014, the credit will increase to a maximum of 50% for firms that sign up with one of the health exchanges).

- Tax-exempt eligible employers will get a 25% health insurance credit against payroll taxes (Note: In 2014, the credit will increase to 35% of contributions).
- Determination and calculation of an FTE employee:
 - Total hours for which an employer paid wages divided by 2,080.
 - Individuals excluded when calculating FTE employees:
 - Seasonal worker hours and wages (i.e., employee works less than 120 days during the taxable year) shall not be taken into account in determining FTE employees and average annual wages.
 - A sole proprietor, a partner, a shareholder owning 2% or more of an S corporation, or any owner of over 5% of any business. Additionally, any member of such person's household is excluded along with such person.
- A new 10% excise tax on indoor tanning services, effective July 2010/

2011

- The value of health care benefits shall be included on employees W-2s for tax years beginning after December 31, 2010; however, amounts contributed to





an Archer MSA, an HSA of the employee or employee's spouse, or the amounts of any salary reduction contributions to an FSA are excluded from the reporting requirement.

- Increased penalty for nonqualified distributions from health savings accounts (up to 20% from 10%).
- Use of flexible spending accounts, health reimbursement arrangements or health savings accounts to purchase over-the-counter medication, unless prescribed by a health care professional, will be prohibited.

2012

- 1099 Reporting - The health care reform package imposes new information reporting requirements. Generally, businesses that pay any amount greater than \$600 during the year to corporate and noncorporate providers of property and services will be required to file an information report with each provider and with the IRS. (for payments made after Dec. 31, 2011).

This is potentially huge! If this does not get amended, this would mean you need to send a 1099 to Dell for buying a computer!

2013

- Employers will lose the tax deduction for subsidized prescription drug plans for Medicare Part D-eligible retirees.
- A 2.9% excise tax on the sale of medical devices will be put into place.
- A \$2,500 limit to an employee's contribution to health care flexible spending account.
- The minimum threshold to claim an itemized deduction for health care expenses increased from 7.5% to 10% of AGI (individuals over the age of 65 stay at the 7.5% threshold through 2016).
- Additional Medicare Payroll Tax
 - A 0.9% Medicare surtax (an increase from 2.90% to 3.80%) on earned income in excess of:
 - \$200,000 per year for single taxpayers;
 - \$250,000 per year for married couples filing jointly; and,

- \$125,000 per year for married taxpayers filing separately.
- Unearned income of taxpayers will be subject to a Medicare tax of 3.8% and imposed on the lesser of:
 - net investment income; or,
 - modified adjusted gross income (AGI) over the above referenced per year threshold amounts.
- Estates and trusts will pay a 3.8% unearned income Medicare contribution tax on the lesser of:
 - their undistributed net investment income for the tax year; or,
 - any excess of their adjusted gross income over the dollar amount at which the highest tax bracket for estates and trusts begins for the tax year.

2014

- Penalties for failure to provide (large employers with 50 or more full-time employees) or obtain (individuals) minimal essential health care coverage.
 - An employer with more than 50 employees will be charged a nondeductible fine for failing to provide adequate and affordable coverage if any full-time employee is enrolled in an insurance exchange and receives premium assistance credit (Note: The fine can be \$167 to \$250 per month, per employee, excluding the first 30 employees).
- Most individuals (and applicable dependents) will be required to maintain health insurance or pay a penalty in an amount greater of:
 - 1% of taxable income or \$95 in 2014; and,
 - 2% of taxable income or \$325 in 2015.
 - As of 2016, the tax penalty will be 2.5% of taxable income or \$695, whichever is greater.
- Premium assistance tax credit for individuals (effective tax years ending after December 31, 2013).
 - Individuals who purchase health insurance through a state health benefit exchange will receive a tax credit when

plan premiums are paid (i.e., an immediate reduction in total premium charged for the plan).

- Eligibility for the premium assistance credit is based on the individual's income for the tax year ending two years prior to the enrollment period.
- Premium assistance credit is available for individuals (single or joint filers) with household incomes between 100% and 400% of the federal poverty level and based on the percentage of income the cost of premiums represents.
 - Threshold ranges from 2% of income for those at 100% of the federal poverty level to 9.5% for those at 400% of the federal poverty level).
 - There will be an inflation adjustment in the starting and ending percentages for years after 2014. The adjustment will be based on the rate of premium growth for the preceding calendar year over that year's rate of income growth.

2018

- An excise tax of 40% will be imposed on high-cost, employer-provided "Cadillac" health plans with annual premiums in excess of \$27,500 for family coverage and \$10,200 for single coverage (Note: The tax is owed by insurers of insured plans and the employer or plan administrator in the case of self-insured plans).

Kansas law provides a credit for employers who start a small employer health benefit plan. If your company has not paid health insurance premiums nor payments to health savings accounts on behalf of an employee for two years, and you start to do so, you are eligible for this credit. The credit can be substantial.

In conclusion, the purpose of this letter is to inform you of potential income tax deductions which may be available to you. We are not making any recommendations here as to any action that you should take. As always we will help as we can with financial and income tax matters.



EXAMPLE

ACME pays five employees wages for 2,080 hours each, three employees for 1,040 hours each, and one employee for 2,300 hours. Partners and members of their households are excluded.

# of Employees	Hours	Total Hours
5	2,080	10,400
3	1,040	3,120
1	2,300	2,080
		15,600

*If number of employees is 1 total hours cannot exceed 2,080.

In this example FTE (full-time equivalent employees) is seven and is calculated by dividing total hours worked (15,600) by 2,080 and rounding down the result.

ACME pays wages totaling \$160,000 to the employees counted above. The average wage is \$22,000 and is calculated by dividing \$160,000 by the number of FTE's (seven) and rounding down the result.

ACME pays health insurance premiums for the above employees in the amount of \$7,000. Applying the 35% of premium contribution credit, ACME's total tax credit is \$2,450 (\$7000 x 35%).

If ACME had 12 FTE employees instead of seven, the credit would be reduced by 2/15. The numerator, two, is the number of employees in excess of 10. The denominator is always 15. (25-10)

If ACME has an average wage of \$30,000 instead of \$22,000, the credit would be reduced by 5,000/25,000 (5,000 is the amount of wages paid in excess of \$25,000).

If ACME had 12 employees and an average wage of \$30,000, then the reduction would be the sum of the two reductions.

