

### *In This Accuracy Update:*

- How Will Employers Withhold for the 0.9% Additional Medicare Tax?
- Does the New Form 1099 Requirement Really Extend to All Payments?
- In the Meantime, What's Going On in Our State Legislature?

## **HIRE Act / Health Care Reform Questions**

Thank you for the tremendous response to our Webinar on the 2010 HIRE Act and the Health Care Reform legislation.

During the Webinar, there were quite a few questions in a couple of areas. This email alert provides further information on those questions.

### **How Will Employers Withhold for the 0.9% Additional Medicare Tax?**

The Health Care Reform legislation provides an additional Medicare tax on highly compensated individuals, effective in 2013. The tax is an increment to the Hospital Insurance (HI) portion of FICA taxes, but the increment is made only to the employee's portion of the tax.

The law says that the 0.9% tax kicks in for wages exceeding \$200,000 for an individual or \$250,000 for joint filers. However, there is no convenient way for an employer to know what an employee's spouse is earning. Thus, an employer's responsibility to withhold and pay over the 0.9% employee's share of the tax is determined by disregarding any earnings of the employee's spouse. IRC §3102(f)(1). Simply put, an employer withholds 1.45% on wages under \$200,000, and 2.35% on wages in excess of \$200,000.

Again, there is no employer's share of the 0.9%. The law does not affect the employer's share of HI taxes for highly compensated employees.

For self-employed taxpayers, both the employer's and employee's shares of the Social Security OASDI tax (6.2% / 6.2%) and the Medicare HI tax (1.45% / 1.45%) are paid on the individual tax return. The taxpayer is allowed an above-the-line deduction for the employer's share of the tax. The additional 0.9% amount, however, is considered employee's share, so it is *not* deductible on the individual return.

If the tax is based on joint income but withholding is based on individual income, what happens? The couple is required to come up with the difference when filing their tax return for the year, just as is done for Social Security and Medicare taxes on self-employment. Thus, this 0.9% tax liability (along with other new items such as the new 3.8% Medicare tax on unearned income which also is effective in 2013) will need to be considered in determining whether, or how much, to pay in estimated taxes over the course of the year. The usual penalties for failure to pay sufficient estimated taxes apply to this tax as well, just as is done for self-employment taxes.

### **Does the New Form 1099 Requirement Really Extend to All Payments?**

No...but very few payments will be exempt.

Under existing law, if a person is in a trade or business and makes a payment of \$600 or more in a tax year in the course of business, then the payer must file a Form 1099 if the payment constitutes:

- Salaries, wages, commissions, fees, and other forms of compensation for services rendered; or
- Interest, rents, royalties, annuities, pensions, and other gains, profits, and income.

Under existing law and regulations, most payments to a corporation did not have to be reported, although medical and health care payments, fish purchases, and attorneys' fees have to be reported regardless.

Furthermore, under prior law, there was no specific requirement to file with IRS an information return for payments aggregating \$600 or more in a tax year to one payee that represented (1) amounts in consideration for property, or (2) gross proceeds.

The new law, effective for payments made on or after January 1, 2012:

- Requires information reporting for payments in consideration for property and gross proceeds; and
- Removes the exemption for payments to for-profit corporations.

What does this mean?

- Does this mean that I will have to file a Form 1099 if I buy more than \$600 in inventory from my supplier, which is a publicly traded corporation?
  - Yes.
- What if I buy a used car from Joe and Joe tells me that he paid far more for the car than the price I am paying?
  - You still need to file a Form 1099. Joe has to tell the IRS he has no gain.
- If I am a tax-exempt corporation, does a payer have to file a Form 1099 if the payer buys more than \$600 of my products and services?
  - No, payments *to* tax-exempt corporations are still exempt from 1099 reporting.
- What about if I am a tax-exempt corporation and I pay more than \$600 to Company A for products or services? By the way, I am *not* deducting the payment for UBTI purposes.
  - "Trade or business" for purposes of this requirement includes not-for-profit activity (even under current law), so you probably still need to file. Reg. §1.6041-1(b)(1); Rev. Rul. 88-53, 1988-1 C.B. 384.

- If my employee holds a business function at a restaurant and I reimburse the employee \$600, do I have to file a Form 1099 for payments to the employee?
  - No, because the payment is not income to the employee; but there is a good chance you'll have to file a Form 1099 for payments to the *restaurant* because the employee was acting on your behalf. Reg. §1.6041-1(e).
- How about if I issue a check to a customer as a refund of a deposit?
  - No, that would not be income to the customer.
- Looking at my vendor list, it looks like I am going to have to issue 250 or more 1099's. Shall I start ordering paper forms? It looks like I will need plenty.
  - You'll need copies to send to your vendors, but if you issue that many 1099's, you are required to file with the IRS *electronically*. The IRS also encourages payers to file electronically even if they have fewer than 250 returns to file. If you do need to file with the IRS electronically, plan ahead; new transmitters need to be approved by the IRS, and that takes time.
- Are there penalties if I don't file the 1099's?
  - Yes. Generally, the penalty is up to \$50 per return that is not filed with the IRS or is filed incorrectly, up to a maximum of \$250,000 per year. This penalty also applies if electronic filing is required and paper returns are filed instead.
  - In addition, there are penalties for failure to furnish payees with correct payee statements. These penalties are \$50 per return, with a maximum of \$100,000 per year; for intentional disregard of legal requirements, the penalty is increased to \$100 per return, with no maximum.

## **In the Meantime, What's Going On in Our State Legislature?**

We are now at the point in the legislative session where both houses of the Legislature have finished their work, and we are now at the point of reconciling any differences that may exist between House and Senate versions of bills. Conference committees composed of both House and Senate members will be appointed to hash out these differences – but these committees are not allowed to insert new matter into any bill, even if the bill title allows it.

- There are no GET increase bills still alive. Thus, it seems that there will be no GET increase this session.
- In addition, there are no income tax rate increase bills still alive.

But it is too early to breathe a sigh of relief. Here are some of the tax bills that are still alive, kicking and sometimes biting:

## Adoption of Federal Tax Changes – or Lack Thereof

This year's bill to adopt or reject Federal changes in the tax code passed during 2009 (**HB 2594 SD1**) proposes nonconformance in these areas, among others:

- Additional sales tax deduction on large purchases (Federal allows an itemized deduction or an addition to the standard deduction, State allows neither)
- NOL carryback (Federal allows up to 5 years, State only allows 2 years)
- Roth IRA conversions (Federal spreads the income inclusion over 4 years; this version taxes it in two years)
- Federal subsidy of COBRA coverage (Federal excludes it from the unemployed worker's income, State doesn't)
- Unemployment benefits (Federal excludes \$2,400, State doesn't)
- Bonus depreciation (State has never allowed this)
- Section 179 expensing (State has only allowed \$25,000)

There are several other, more specialized areas of proposed nonconformance. In addition, this version of the bill would provide that monies held in the litigated claims fund would bear interest at the federal rate under Code section 6621(a).

## General Excise Tax as a Trust Fund Tax?

**HB 2595 SD2**, sponsored by the Department of Taxation, would deny the benefit of any lower rate, credit, deduction, or income split, unless the taxpayer files a return within one year after the return is due. It would also impose personal liability against a "responsible person" in a business that fails to pay the general excise tax, just as the IRS does for businesses that withhold tax from employees and fail to pay that tax over to the government. The Federal code calls the withholding tax a "trust fund" tax to justify this treatment – the money doesn't belong to the employer, who is only holding it in trust for its employees to satisfy their obligations to the Government. Although the Senate bill was held in committee, the House version crossed over and bypassed the Senate committee that killed its counterpart.

## Refundable vs. Nonrefundable Credits

When a taxpayer has too many credits, what happens? Under prior procedure that applied to all nonrefundable credits other than the high technology credits, nonrefundable credits were applied first. The refundable credits were treated as payments, so that a taxpayer having excess credits would be issued a refund check. **HB 2596**, a Department of Taxation-sponsored bill that is now on the Governor's desk, turns this around. Refundable credits would be used first, so a taxpayer with excess credits would normally get a credit carryover balance – and no refund check.

## We Just Moved the GET Return Due Date, So Let's Do the Same for Other Taxes

**HB 2600**, also on the Governor's desk, would change the due dates for returns other than GET returns to the 20th of the month following the close of the reporting period. Returns of insurance premium tax, which are now due quarterly, would start being filed monthly.

## Interest on Tax Refunds

Under current law, the State does not have to pay interest on a State tax refund if the refund order is given within 90 days after the return is filed or the return is due, whichever is later. This year, the Department of Taxation raised eyebrows when it announced that it would not pay any 2009 tax refunds until July 1st at the earliest. **HB 1948 SD1** requires refunds to taxpayers within 90 days of the filing of the return or, if earlier, the due date of the tax, discovery date of the overpayment in an amended return, or the date of determination by the Director of Taxation. The Senate changed its effective date to July 1, 2020, so it would need to be fixed in conference before facing what may be opposition by the Governor.

## High Technology Credit Burial

Both **SB 2001 HD1** and **HB 2984 SD2** give another year of life to the tax credit for research activities, sometimes known as the 20% refundable R&D credit, but in the process would repeal the technology infrastructure renovation tax credit and the high technology business investment tax credit. SB 2001 would take effect on May 1, 2010 and would not affect credits earned before the effective date, including carryover credits. It is not clear whether HB 2984 would be retroactive.

## If It Happened in Vegas and Your Money Stayed in Vegas...

**SB 2834 SD1** reinstates the net income tax deduction for gambling losses that was taken away last year. This reinstatement would be retroactively effective to January 1, 2009.

## Stranding the Itemized Deductions and the Capital Goods Credit

Although a prior version of **HB 1907 SD1** suspended the ability to carry back net operating losses for losses incurred in 2009 and 2010, enough testifiers raised concerns so that language was deleted. The bill still imposes a hard maximum on the amount of itemized deductions that a taxpayer may claim (\$100,000 for married filing jointly or surviving spouse, \$50,000 for single or married filing separately, and \$80,000 for head of household). The bill also makes the Capital Goods Excise Tax Credit nonrefundable until 2015.

## Let's Stick the Smokers Again

**HB 1985 SD1** increases the tobacco tax rate from 11 cents to 15 cents per cigarette effective July 1, 2010, and then increases it another penny one year later. It also repeals the Hawaii itemized deduction for political contributions effective in 2011, and doubles the user fees for insurance licenses and certificates from July 1, 2010 to June 30, 2013.

## GET Exemptions...If You Can't Swat Them the First Time, Try, Try Again

In our last report, we noted that HB 2877 HD1 contained a list of exemptions from the general excise tax, use tax, and the public service company tax which would instead be taxed at 1% from July 1, 2010, to June 30, 2015. Because that bill didn't gain traction in the Senate, the House Finance Committee took an unrelated bill that crossed over, gutted it, and inserted the contents in modified form into **SB 2402 HD1**. Among the exemptions that would be subject to the new 1% rate, which now spares the public service company tax from change, are:

- The deduction by a contractor for amounts paid to a subcontractor.

- The exemption for property or services exported out of state.
- The partial deduction a sublessor gets for lease rent paid for the space subleased.
- The exemption for intercompany services and interest between related entities.
- The exemptions for amounts paid by hotel operators, orchard operators, and professional employment organizations as wages and benefits.
- Several exemptions under the general excise and use taxes relating to commercial aircraft operation.
- The exemption for the sale of tangible personal property to the U.S. Government and state-chartered credit unions.
- The exemption for gross proceeds of shipbuilding and ship repair.

### **Streamlined Sales Tax Agreement...With Technology Extras**

Hawaii, like many other states, has been missing out on collecting GET or Use Tax on goods sold to residents by out-of-state sellers that are outside of the reach of the State's taxing jurisdiction. Although the tax does indeed apply to purchasers of such goods, it is not cost effective for the State to chase multitudes of small purchasers. Thus, there is interest in the increased collection from remote sellers that is supposed to come with joining the Streamlined Sales Tax Project (SSTP), a national initiative by many similarly situated states. In 2003, the State of Hawaii became a participant in the SSTP. A further act in 2005 advanced the State's efforts to comply with the terms and conditions of the conforming legislation reflected in the SSTP model agreement and act. However, there is currently a large issue: The SSTP requires a maximum of one tax rate per state, but the GET and Use Tax now have two major rates, namely the wholesale and retail rates. Legislation to split off the wholesale from the retail rates was passed in 2009 but was vetoed by the Governor, who cited concerns with ceding control to the SSTP governing body, providing amnesty, payment of a collection fee to an out-of-state vendor, and an ambiguous effective date. **HB 2962 SD2**, which started off in the House as a very different bill, is the current version of the SSTP rate split-off legislation.

The bill also provides that the technology infrastructure renovation tax credit and the high technology business investment tax credit will not be usable between July 1, 2010 and June 30, 2013; these provisions were in the House version of the bill.

### **And Then There's the Barrel Tax**

Chapter 243, HRS, imposes the fuel taxes. Among them is the environmental response tax, which is currently imposed at 5 cents (\$0.05) per barrel of petroleum product sold by a distributor. HB 2421 SD2 would raise the tax to \$1.55 per barrel (an increase of 3000%) and divide the booty among the general fund and four special funds, one of which would be created by the bill. The general fund would receive \$1 per barrel.

Information on these and other bills moving through the Legislature may be obtained from the Legislature's web site, [www.capitol.hawaii.gov](http://www.capitol.hawaii.gov).

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In any event, your client service team at Acuity can bring you the resources that you may need.

Please do not hesitate to contact your client service team for more information

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