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Payroll Questions Answered by Federal Panel at APA Congress

A panel of federal agency executives answered questions submitted by participants at the American Payroll Association's 26th Annual Congress in Austin, Texas. Members of this year's panel included: Sonja Barnes, Chief, Customer Relationship and Learning Management Branch, Verification Division, U.S. Citizenship and Immigration Services, Department of Homeland Security; Martin Barrow, Regional Manager, Southwest Region, Wage and Hour Division, Department of Labor; Anita Bartels, Senior Program Analyst, Small Business/Self-Employed Compliance Policy, Office of Employment Tax, Internal Revenue Service; Linda Buehring, Senior Special Agent, U.S. Immigration and Customs Enforcement, Department of Homeland Security; Sherri Grigsby, Manager, Employer Services and Special Matching Programs, Office of Child Support Enforcement; Chuck Liptz, Director, Employer Wage Reporting and Relations, Social Security Administration.

This issue of PAYROLL CURRENTLY features IRS and SSA questions. Future issues will include answers to questions presented to the Office of Child Support Enforcement, the Department of Labor, U.S. Citizenship and Immigration Services, and U.S. Immigration and Customs Enforcement.

Internal Revenue Service

Failure to withhold pursuant to a tax levy

Q. For failure to timely withhold amounts due under a tax levy, an employer may be ordered to pay an amount equal to the amount that should have been withheld. Does that money pay down the employee's tax debt, or is it merely a penalty against the employer? If it does pay down the employee's debt,

does that create a taxable benefit for the employee?

A. The debt becomes the employer's if the employer fails to withhold. If an employer does not honor a wage levy, then the employer becomes liable for the amounts that are not turned over to the IRS (IRC §6332(d)). After that, any amounts that are collected under the levy or pursuant to an enforcement action will be credited to the employee's delinquent tax debt and will qualify as tax payments the same as voluntary tax payments, and there is no taxable event to the employee. In addition, the IRS can take the employer to court and assert a 50% penalty. That penalty is a penalty against the employer; it does not pay down the employee's debt.

Reporting HSA contributions

Q. How are employee and employer contributions to Health Savings Accounts reported on Form W-2? Does an employee with an HSA have any extra responsibilities when filing his or her personal income tax return?

A. According to the instructions for Box 12 of Form W-2, the employer should show all employer contributions, including amounts that the employee elected to contribute through a cafeteria plan to an HSA. So it goes in Box 12 on Form W-2.

Generally speaking, an employee who has any HSA activity has to complete Form 8889, *Health Savings Accounts*, and attach it to his or her tax return. In addition, an employee might have to report taxable distributions on Form 1040 as "other income," and under certain circumstances the employee might be able to take an HSA deduction on Line 25.

Health FSA contribution limits

Q. May an employer allow employees with more years

Payroll Solutions

Q. We have over 200 employees, and we offer them health insurance (individual or family coverage). One employee with family coverage has just died, and his spouse would like us to continue the “family” coverage. Are we required to do this? If so, for how long? And what about the premium?

A. You should continue the family coverage in this situation. The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) requires health plan sponsors to provide employees and their beneficiaries with the opportunity to elect continued group health coverage for a given time period should their coverage be lost due to certain “qualifying events,” one of which is the death of a covered employee. Note that COBRA requirements apply to companies with 20 or more employees.

Qualified beneficiary. A qualified beneficiary entitled to COBRA continuation coverage includes the spouse and/or dependents of an employee covered by the health plan on the day before a qualifying event occurs. Here, the employee’s spouse was covered under the health plan on the day before the employee died, so she is entitled to COBRA continuation coverage. (If the spouse had not been covered by the employer’s health plan on the day before the employee’s death, there would be no right to COBRA continuation coverage.)

Period of coverage. Because the qualifying event in this case is the employee’s death, the employee’s spouse is entitled to 36 months of COBRA continuation coverage. The period of coverage can terminate sooner in certain circumstances, such as if your company decides to stop offering health insurance to employees.

Premium. A group health plan can require the qualified beneficiary to pay a premium for continuation coverage of up to 102% of the group premium paid for similar coverage under the plan by the company and its employees. The individual can choose to pay premiums in monthly installments. The first premium payment may not be required earlier than 45 days after a qualified beneficiary elects continuation coverage.

For more information on COBRA election and notice provisions, as well as other requirements, see *The Payroll Source*® beginning at p. 4-11.

of service to contribute greater amounts to a health Flexible Spending Arrangement – for example by allowing employees with fewer than five years of service to put in up to \$2,000, employees with between five and nine years of service to put in up to \$4,000, and employees with 10 or more years of service to put in up to \$6,000?

A. An arrangement that allows different people to put in different amounts of money based on longevity may be problematic, and the reason is that it may inadvertently discriminate against lower-paid employees because they’re often the ones who have the fewest years of service. The nondiscrimination rules that apply to cafeteria plans are intended to ensure that nontaxable benefits are provided to lower-paid employees as well as highly compensated and key employees.

There are two kinds of discrimination. In this case, discrimination with respect to participation would probably not be an issue, but discrimination with respect to benefits could be. What could happen is that if higher-compensated employees get benefits that exceed those received by lower-paid employees, then the plan could be considered to be discriminatory. So although there isn’t a specific prohibition against this kind of plan, if you’re considering doing something like this you might want to be sure that your plan won’t wind up discriminating in favor of your highly paid or key employees.

Form W-9

Q. What information must a payer company have on file for individuals or organizations to which the company will make payments from its accounts payable department? Is a Form W-9, *Request for Taxpayer Identification Number and Certification*, required from each payee?

A. Requiring a Form W-9 shows that you as the payer have exercised due diligence and business prudence by securing a Taxpayer Identification Number (TIN) from your supplier. While you are not required by law to get a W-9 from a payee in most situations, it’s just good business practice.

The W-9 is used to request the TIN of a “U.S. person” – which includes partnerships, companies, or associations created or organized under U.S. law, as well as individuals who are U.S. citizens or U.S. resident aliens. *Note:* Remember that corporations that provide medical or legal services must also receive Forms 1099.

The W-9 shows that you made an effort to get the correct number. It can be used not only to get a TIN (i.e., EIN or SSN), but also to identify the nature of a payee (i.e., business or individual). If the number-TIN combination turns up incorrect on the 1099, then the W-9 gives you back-up.

Emergency assistance from employer, co-workers

Q. Imagine that an employee suffers a catastrophic house fire and loses everything. The employer gives the employee \$5,000 to help re-establish the household. Is this emergency assistance payment taxable? If the employee’s co-workers set up a fund for the employee, may the co-workers take a tax deduction for their contributions?

A. If the \$5,000 from the employer is simply a gift, then it cannot be excluded from gross income but it’s not wages. In this case, the employee is going to be able to take a deduction for a casualty loss that is not compensated “by insurance or otherwise.” If the \$5,000 is designed to reimburse the employee for the loss, then it is not included in income, but the employee must reduce the casualty loss by the amount received as compensation “by insurance or otherwise.”

If the employee’s co-workers set up a fund, contributions to the fund will not be tax deductible to the co-workers because they have identified the recipient (private purpose vs. general fund). However, the money from the fund will not be wages to the recipient because it was set up by the employee’s co-workers. It’s “other income.” The \$5,000 is not wages, so it’s not going to go on the employee’s W-2; it’s going to go on a 1099. And it will be taxable to the employee.

Taxability of employee travel

Q. A company holds an annual meeting for its top sales staff and their spouses at a resort hotel with golf, tennis and

other recreational facilities. What are the standards that must be met to ensure that the company does not have to tax its employees on the value of the airfare, lodging, etc.? For example, is there a minimum amount of time that must be spent in meetings?

A. The taxability of employee travel depends on whether it can be deducted by the employer and on the facts and circumstances of each case. Reasonable, ordinary, and necessary business expenses can be deducted under IRC §162.

In this case, where the spouses are invited to go along, that is not a business expense to the employer. Consequently, the fair market value of the spouses' airfare and so on is a taxable fringe benefit to the employees who are attending the meeting.

In order for travel to be deductible as a business expense, the employee has to substantiate the amount of the expense, the time and place of the meeting, the business purpose, etc. There is no specific amount of time that has to be spent in meetings, but there has to be a legitimate reason for making the trip.

'Safe harbor' tax deposit rules

Q. Under the "safe harbor" rules for tax deposits, an employer will not be penalized if it deposits less than its full tax liability, so long as a) the rest of the deposit is made on time, b) the shortfall is no more than the greater of \$100 or 2% of the entire amount due, and c) the shortfall is deposited by the appropriate "make-up date," which could be a month or more after the original due date (see IRS Pub. 15). What if the shortfall is \$100,000 or more? Does the one-day deposit rule override the safe harbor? What if the shortfall from multiple deposit periods accumulates to \$100,000 or more?

A. If the shortfall is more than \$100,000, the one-day deposit rule overrides the safe harbor. This is also true if the shortfall for multiple deposits accumulates to \$100,000 or more. So any time there is \$100,000 or more of accumulated employment taxes, the one-day deposit rule applies.

Form 2159 and Letter 3676

Q. When employees enter into voluntary arrangements with the IRS to pay back taxes, two forms often come into play – Form 2159, *Payroll Deduction Agreement*, and Letter 3676, *Payroll Deduction Installment Agreement Fax Letter*. Is an employer required to implement a deduction pursuant to either of these forms? If a deduction is implemented, what is its priority in relation to other deductions? What happens if a deduction is implemented and then the employee wants to change or discontinue it?

A. Form 2159 is the actual payroll deduction agreement, and Letter 3676 notifies the employer of the agreement. An employer is not required to enter into one of these agreements; entering into an agreement is voluntary on the part of the employer. Of course, we at the IRS encourage payroll deduction agreements in situations where the taxpayer is a wage earner and especially in situations where the taxpayer has defaulted on a previous installment agreement with us. This way the payment is coming through the employer.

If an employer does enter into a payroll deduction agreement, then the priority of the payment is spelled out in the *Notice of Federal Tax Lien*, which includes a telephone number. If you have questions about the priority, you can call that number and they will talk to you about it.

Because it's a voluntary agreement, either the employer or the employee can request that it be changed or discontinued. There's no penalty if you honor the employee's request, but you might expect a tax levy notice to follow.

COBRA premiums and cafeteria plans

Q. May a cafeteria plan be used to pay COBRA health insurance premiums on a pre-tax basis? This could be applicable if, for example, an employee's dependent exceeds the age at which the employer will cover him or her, or if a new employee is paying COBRA premiums to a former employer until he or she becomes eligible for coverage under the current employer's health plan.

A. Yes. A cafeteria plan can pay COBRA premiums under those conditions and in general.

Missing SSN

Q. What are an employer's responsibilities with regard to an employee who has never provided a social security number?

A. When an employee starts work, the employer should get a signed Form W-4 from the individual. The form is effective with the first pay period and should contain all of the information necessary for withholding. If you don't have that information, you withhold as though the employee were single with no dependents.

The social security number is more important for your dealings with the Social Security Administration than with the IRS.

Credit card company as QPCA

Q. If a credit card company becomes a Qualified Purchasing Card Agent as described in IRS regulations, how will employers be notified? Until an employer's purchasing card company becomes a QPCA, what are an employer's responsibilities for information reporting and backup withholding with regard to merchants from whom it has purchased products and services using a company credit card?

A. Both Visa and Mastercard have applied for QPCA status, but there is no indication on either company's website that they have been accepted, and I think we can be sure that if they had been, they would have reported it there.

The responsibility for notifying cardholders of QPCA status rests with the card companies. Notice will not come from the IRS.

Until somebody is accepted as a QPCA and assumes the responsibility for TIN solicitation and TIN matching on behalf of cardholders, the responsibility for these things is going to remain where it is now. That means that backup withholding is the responsibility of the cardholder, just as it would be in the case of direct payments to vendors such as when somebody refuses to provide a TIN.

Gym fees incurred while traveling on business

Q. When employees travel on business, may an employer reimburse or pay the fees they incur to use fitness facilities at or near their hotels without including these payments in wages? Many employees already pay for a gym membership at home so that this is an extra expense they wouldn't incur if it weren't for their business travel.

A. No, this is a personal expense. It's not excludable under IRC §132 because the facilities are not on the premises of the employer. It's also not deductible under IRC §162, which is ordinary and necessary business expenses. If you reimburse these expenses, it's taxable.

Wages paid after death: 401(k) deferral

Q. May wages paid after death be deferred into a 401(k) plan? On the one hand, those wages aren't subject to inclusion in W-2 Box 1, so it doesn't seem possible to have a deferral. On the other hand, the employer could take the 401(k) deduction out of the payment to the decedent's beneficiary and adjust the

decendent's previously accumulated federal taxable wages by that amount.

A. Generally, contributions to a retirement plan like a 401(k) can only be made from compensation received prior to severance of employment, which in this case would be death. However, 26 C.F.R. §1.415(c)-2(e)(3) provides for certain exceptions. It allows wages paid after death to be deferred into a 401(k) plan if the plan permits it; any deferred wages would have to be determined according to the regulation.

Social Security Administration

SSN vs. ITIN

Q. If employees are set up in their employer's system with Individual Taxpayer Identification Numbers and the employer does not get social security numbers to replace the ITINs, should the employer file Forms W-2 with the ITINs in the SSN box or leave the SSN box blank?

A. By the book, the answer to this question is if you have an ITIN, you should use all zeros. That said, some payroll systems will not accept all zeros in the SSN field. If you can't put in all zeros, all you have is what they gave you, which is the ITIN. As you know, the ITIN is not a valid number for working, but because it's the only thing you've got, you should put it in the SSN field. Of course, we're not going to be able to validate that name and SSN, so the wages that come in on that W-2 will go into the earnings suspense file and will sit there until a valid SSN is provided.

Business Services Online

Q. What are the newest features at Business Services Online, SSA's suite of services on the web, and what is planned for the next filing season?

A. We're making some changes to our registration process. In the past, if you forgot your BSO password, you had to go to our website and request a new one. We would send it to you by mail and you would get it a few days later. What we are going to do starting at the end of July (see **PAYROLL CURRENTLY, Issue No. 11, Vol. 16**) is ask you a series of baseline questions – things like your mother's maiden name or your high school – at the time you apply for a password. Then if you forget your password later, and if you answer the same questions correctly, you'll be able to reset your password.

Right now when you register, we ask you personal information – name, SSN, date of birth, and employer information all on one screen. That's going to be separated onto two different screens. It's going to be a little different.

Those are really the main changes. You'll still be able to file electronically. You'll still be able to verify names and numbers with us over the Internet. Those processes aren't going to change.

Correcting W-2s with incorrect SSNs

Q. If an employer discovers that an employee's Forms W-2 have been filed for several years with an incorrect SSN, does the employer have to file a W-2c for each year?

A. Yes, you must send a W-2c for each year where you have an incorrect SSN in order to ensure that we correct the earnings record for each of those years. We will go into what's known as the earnings suspense file – where we keep each W-2 item with a name and number that don't match – and pull each one of those items out and properly post them to the employee's earnings record.

Form W-2: changes to the paper form

Q. What change was made to the paper Form W-2 this year? What was the impact of that change?

A. The paper W-2 had a field for the social security number that was close to the field for the name and address. If you had a window envelope, the SSN was sometimes visible. When this was pointed out to us, we worked with our colleagues at IRS and in the payroll software community and we made a change to the W-2 form. We moved the field at the top of the form with "22222" over a bit, and we put the SSN up there so that it would not be near the name and address.

But then this year, up where the "22222" used to be, other things appeared like names and other characters. So there's still work to be done to educate people about the new form.

Third-party sick pay checkbox

Q. On Form W-2, should the "Third-party sick pay" checkbox be checked only by the third party, or also by employers when the W-2 contains any third-party sick pay? What is the purpose of this checkbox?

A. IRS Publication 15 explains that you should check the third-party sick pay checkbox if you are a third-party sick pay payer filing a Form W-2 for an insured employee or an employer reporting sick pay payments made by a third party. So in the example that was given, the answer would be yes in both cases.

The purpose of the checkbox is to provide information. As I'm sure most of you know, the W-2 is an IRS form that's processed by SSA, so we pass the information over to the IRS so they can also utilize it.

SSNVS vs. E-Verify

Q. Can you explain the difference between the Social Security Number Verification Service and E-Verify? Are they interchangeable, particularly in the states that are requiring use of E-Verify for certain employers? Are the results from using SSNVS shared with the IRS or the Department of Homeland Security?

A. The Social Security Number Verification Service is a free service that SSA offers to allow you to verify names and social security numbers for wage reporting purposes only. It's intended to ensure that the W-2s you send to SSA match our records. It has no other purpose than that. It does not provide some of the information that E-Verify provides.

Note: On our Business Services Online website, you'll also find something called Consent-Based SSN Verification. This is a new fee-based service that verifies names and numbers. It doesn't really fit in the payroll environment because we provide the same service for free for wage reporting purposes. It may be used by, for example, a mortgage company or credit agency. We do not offer verification for free in these circumstances; we charge a fee. And you have to sign up for the service. Right now, the closing period is June 30, 2008. There's an up front enrollment fee of \$5,000 to use the service, as well as an estimated transaction fee of \$0.56 per SSN submitted. Companies that want to use the service are going to have to pay the cost of providing it so that SSA doesn't have to take money out of the trust fund.

SSNs for foreign employees

Q. What are the best steps for a foreign employee to take after arriving in the U.S. to ensure the quickest possible issuance of a social security number? What should an employer do if the employee still does not have a social security number when it's time to issue Forms W-2?

A. When a person arrives in the United States, we recommend that he or she wait 10 days before going to a local

SSA office to apply for a card, to allow time for information to get through the Department of Homeland Security system into the SAVE (Systematic Alien Verification for Entitlements) system. Then the person should bring proper documentation, of course, to show that he or she was legally admitted into the United States (e.g., a foreign passport).

If the person does not have a number and it's time to issue W-2s, all you can do is put zeros into the SSN field. Or you can write "applied for" in the SSN field on a paper W-2.

Social security cards

Q. What are the newest features on the social security card?

A. We've added color shifting – like what you see on the new \$20 bill. We've also added a little band on the card that looks like a line but that really says "Social Security Administration" over and over. These are security features. Other new features include a date of issue in the lower right-hand corner of the card, and – starting last October – all new cards have the last name on a separate line. We worked with the APA for five years on this. We understand the concerns you have that it's often difficult to distinguish what is a middle name and what is a last name.

If you use SSNVS and you are not certain of the last name, we tell you whether we match the name you have submitted. For example, if you have the name Jean George Jones, and you try Jean Jones and it doesn't match, you may want to try it with George as the last name. We have routines we run to see if people are "phishing" by using a lot of choices, but we also understand that you are not always certain what the last name is. So you may – if a name kicks out the first time and you think a middle name may be listed as the last name or the person may have gotten married or changed their name – try different variations in SSNVS and get an instant response as opposed to having to send the person to the local field office for a new card.

We don't want people to go to field offices to get replacement cards if they don't really need them. It's a cost to the agency, as well as a cost to employers and the employee. We encourage you to use SSNVS to determine what the last name is.

Incorrect SSN

Q. If an employee provides an SSN to a new employer, but SSNVS tells the employer it's wrong and the employee won't supply any other information, what should the employer put in the SSN box on Form W-2?

A. SSNVS is designed to verify a person's name and social security number, and if there's a mismatch, we send you back a mismatch code. You can also input gender and date of birth, and if the name and number match but the gender or the date of birth do not agree with our records, we will send you a mismatch in this case as well – even though the name and number do match. You should look at that carefully, and just because there's a mismatch, you should not assume the number is bad. You may simply want to inform the employee that their SSA records need to be straightened out.

In a situation where the name and number do not match and you ask the employee to supply some other documentation and the employee refuses, then you have to work with what you have – the name and number on the W-4. Even though you know it's not accurate, that's the name and number the employee has attested to. So that's what you are going to have to send in to SSA on the employee's W-2.

Electronic wage reporting

Q. How are SSA and software developers working together to make wage reporting easier?

A. A few years ago, Congress set a goal of 80% electronic processing by 2008, and SSA has reached that goal; last year we were at 81% electronic processing. About five years ago, we processed about 150,000 magnetic media and electronic files. Now magnetic media is gone; it's all electronic. Last year we processed 450,000 electronic files. The effect of that increase in volume has been to slow our processing a bit.

We have been working with the software developer community, looking at more ways to automate and streamline our processes. But we're not ready to roll anything out yet. A tidal wave of Baby Boomer claims is coming into our field offices and hitting our systems, and that is where SSA is using a lot of its resources. A lot of SSA resources are being reallocated. Implementation of some of our ideas for further streamlining is being pushed out a little further than we originally anticipated. ■

ERISA Preempts State Law Prohibiting Automatic Enrollment in Benefit Plan

The U.S. Department of Labor (DOL) has released an Advisory Opinion Letter under ERISA §514(a), which generally preempts state laws related to employee benefit plans [DOL Advisory Op. 2008-02A, 2-8-08; www.dol.gov/ebsa/pdf/ao2008-02a.pdf]. The letter, which was issued to the Sprint Nextel Welfare Benefit Plan, concluded that §514(a) preempted a Kentucky state law (KRS §337.060(1)) requiring an employer to obtain written consent before withholding amounts from an employee's wages "to cover insurance premiums, hospital and medical dues, or other deductions."

Section 514(a): background

Section 514(a) of ERISA states that the provisions of Title I of ERISA "supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b)." The DOL explains that when Congress enacted §514(a), it intended, among other things, "to ensure that plans and plan sponsors would be subject to a uniform body of benefits law; the goal was to minimize the administrative and financial burden of

complying with conflicting directives among states or between states and the federal government." And the U.S. Supreme Court has said that a state law "relates to" an ERISA benefit plan if it makes "reference to" or has a "connection with" employee benefit plans.

DOL opinion: state law 'relates to' ERISA plan

Here, the DOL said the Kentucky law meets the "relates to" test with respect to ERISA plans because it prohibits automatic enrollment arrangements in such plans and regulates Sprint Nextel's decisions on how it provides employee medical coverage and plan funding. KRS §337.060 "implicates an area of core ERISA concern" because it directly interferes with plan requirements on eligibility for participation and benefits and the plan funding mechanism. The DOL notes that ERISA regulations specifically address employer handling of payroll deduction contributions. "In light of the pervasiveness of wage withholding as a vehicle for funding employee benefit plans and the Kentucky law's express inclusion of deductions to cover employee contributions for 'insurance premiums, hospital

and medical dues,' it appears that employee benefit plans are among the entities at which the written consent requirements ... are specifically directed." The Kentucky provision is therefore preempted by §514(a) of ERISA to the extent that it limits, prohibits, or regulates deductions from wages for contributions to ERISA-covered plans.

In an earlier ruling, a written consent requirement in a New York wage withholding law (NY Labor Law §193) was similarly preempted to the extent that it prohibited employers from allowing their employees to implement or change salary reduction contributions to ERISA-covered plans via telephone or voice response system. ■

IRS Issues Guidance on Preparation of Substitute Returns in Misclassification Cases

The IRS has released a legal memorandum offering guidance on the authority of revenue officers to prepare substitute returns in employment tax cases with worker classification issues [ILM 200822026, 2-26-08 (released 5-30-08)].

Background

For the years at issue, an employer took the position that certain workers were independent contractors for federal tax purposes. However, in previous years the employer had treated the workers as employees. The revenue officer assigned to the case determined that the workers should have been treated as employees and prepared substitute returns. When the employer appealed, the question was whether the revenue officer, who had not followed the procedures in the *Internal Revenue Manual* (he had failed to refer the issue to the Employment Tax Examination Program), had the authority to prepare substitute Forms 941.

Note: Under IRC §6020(b), if any person fails to make a required return or makes a false or fraudulent return, then the IRS is authorized to make a substitute return based on its own knowledge and investigation.

IRC §7436 and Notice 2002-5

IRC §7436 gives the Tax Court jurisdiction to determine certain "worker classification issues." To meet the requirements of IRC §7436, certain procedures must be followed prior to assessment of employment taxes. Notice 2002-5 (2002-1 C.B. 320) describes those procedures.

Here, because the revenue officer failed to meet the procedural requirements spelled out in Notice 2002-5, his assessment of employment taxes was improper. Rather than concede the case, however, the memorandum says that if procedural defects are corrected and the requirements of IRC §7436 are met, then "employment taxes may thereafter be assessed."

Conclusion

In employment tax cases where worker classification issues are present, revenue officers have authority to prepare employment tax returns, but the requirements of IRC §7436 must be met prior to assessment. ■

Time Spent Attending College Classes and Doing Homework Was Not Compensable

When Paul Loodeen was hired by Consumers Energy Company in March 2004, he agreed to obtain a "CES Educational Certificate" within two years. He began taking the required classes in August. In November 2006, Loodeen sued Consumers under the Fair Labor Standards Act (FLSA), arguing that he was entitled to compensation for his classroom time, homework time, and travel time because the classes were not voluntary and were related to his job. He lost [*Loodeen v. Consumers Energy Co.*, No. 1:06-cv-848, 2008 U.S. Dist. LEXIS 19978 (WD Mich. 3-14-08)].

Lectures, meetings, and training programs

Under FLSA regulations (29 C.F.R. §785.27), the time spent by an employee attending lectures, meetings, seminars, and training sessions is compensable worktime (and therefore includable in overtime calculations) unless *all* of the following conditions are met: (1) the meeting, lecture, etc., is held outside of the employee's regular working hours; (2) attendance is voluntary (not a condition of employment); (3) the meeting, lecture, etc., is not directly related to the employee's job; and (4) the employee does not perform any productive work for the employer while attending (see *The Payroll Source*®, pp. 2-58 and 2-59).

Here, the court said the "working time" test set out in §785.27 did not apply because the training involved was more than a few hours of continuing education or recertification in connection with existing job duties; it was part of a multi-year attempt to qualify for a new position in the company. Loodeen had virtually no technical skills when he was hired as an intern with the understanding that he would complete a series of

courses to become certified for a specific position within two years. He was free to select the college and when he would take the classes. The courses were held away from company premises and outside Loodeen's regular work hours.

'Integral and indispensable' to the job

An employer need not compensate an employee for activities that are "preliminary or postliminary" to the employee's principal activity. However, when those activities are "integral and indispensable" to the job (i.e., necessary to the principal work performed for the benefit of the employer), the employee must be paid (see *The Payroll Source*®, pp. 2-59 and 2-60).

The time Loodeen spent in class was not integral and indispensable to his principal work activities, said the court. He was hired as an intern but held that position only a few months. He then held the position of Distribution Assistant, which involved some CES work, but this did not mean that the CES-required classes were integral and indispensable to his job; he was able to perform his job without obtaining a CES certificate.

Employment status

Loodeen's employment both as a CES intern and as a Distribution Assistant was contingent on his obtaining a CES certificate within a certain time period. His status was analogous to an apprentice or a probationary (temporary) employee working toward certification for a higher level position. He was entitled to compensation for his time spent performing the principal activities of his present employment, but not for student training for the higher paying position.

Consumers could have chosen to make the certification a precondition of employment, explained the court. It did not hire Loodeen to be a student.

On-call time

Finally, Loodeen's time after work – in classes, doing homework, and traveling to and from school – was not compensable "on-call" time. On-call time is compensable if

the restrictions imposed on an employee are so onerous as to prevent the employee from using the time for personal pursuits. Here, Loodeen's attendance at classes was itself a personal pursuit. He voluntarily agreed to take them and derived significant personal benefits from them – increasing his knowledge and working toward qualification for a higher paying position. ■

IRS Offers EITC Website for Employers

A new website can help businesses play a role in spreading the word about the Earned Income Tax Credit for low income working families. Visit www.irs.gov/individuals/article/

for forms and schedules, publications (including posters, stuffers, and brochures), online tools, and related resources. ■

Employee Owed Over \$11,000 for Minimum Wage and Overtime Violations

Fico Key West Seafood operated a seafood restaurant, fish market, and cafeteria. Odalys Perez worked six days a week in the cafeteria. She was scheduled to work from 7:00 a.m. to 3:00 p.m. on Mondays and Tuesdays, and from 9:00 a.m. to 9:00 p.m. Thursday through Sunday. Perez received no compensation for her work an hour before and a half hour following her Monday and Tuesday shifts, or for the 45 minutes she worked beyond the end of her Thursday through Saturday shifts – a total of six hours per week. When Perez sued the restaurant to recover unpaid minimum wage and overtime compensation under the Fair Labor Standards Act (FLSA), a U.S. District Court said that she was entitled to unpaid wages of nearly \$5,800, and an equal amount in liquidated damages [*Perez v. Palermo Seafood, Inc.*, No. 07-21408-CIV-O'SULLIVAN (CONSENT), 2008 U.S. Dist. LEXIS 15913 (SD Fla., 3-3-08)].

Manager was an employer

Under the FLSA (29 USC §203(d)), an employer is "any person acting directly or indirectly in the interest of an employer in relation to an employee." A corporate officer who has operational control over a corporation's FLSA-covered enterprise is a joint employer along with the corporation. (Joint employers are responsible, both individually and jointly, for FLSA compliance.)

Here, the court said that Perez's manager, Juan Ziggenhirt, was an employer for FLSA liability purposes, along with the corporation operating the restaurant. He was the president of the corporation and owned 25% of the stock. He exercised control over the business, financial, and employment affairs of the restaurant. Ziggenhirt was at the restaurant six days a week supervising its employees, had the power to hire and fire employees, and set policies for the restaurant (including its overtime pay policy).

Minimum wage and overtime compensation due

An exact calculation of the minimum wages and overtime due Perez was difficult because Fico paid Perez in cash during the first three months of her employment. After that, the restaurant paid part of her wages by payroll check and the remainder in cash. When the restaurant hired a payroll

provider to handle its payroll, the restaurant underreported Perez's hours worked in each pay period and did not report its cash payments. The restaurant kept no records of its cash payments to Perez or the hours that were not reported to the payroll provider.

The court explained that where an employer's records cannot be trusted and the employee lacks documentation, if an employee proves that he or she has performed work that was not properly compensated and the amount of work and extent of the work can be established "as a matter of just and reasonable inference," then the court may approximate the amount due and award damages to the employee. Here, there was evidence that Perez was not compensated at 1.5 times her regular rate of pay for her hours worked in excess of 40 in a workweek.

The restaurant knew or should have known that Perez was regularly working more than 40 hours per week because it established the policy of requiring Perez to report only a portion of her hours worked on time cards and did not communicate the unreported hours to its payroll provider. Moreover, the restaurant violated the minimum wage and overtime requirements of the FLSA by failing to compensate Perez for the time she worked before and after her shifts. The court concluded Perez was entitled to \$5,773.20 for her six uncompensated hours each week and for her uncompensated overtime.

Liquidated damages

An employer that violates the FLSA is automatically subject to "liquidated damages" (i.e., an additional equal amount) unless it can show a good faith basis for its actions. Here, the court said liquidated damages were warranted because the company did not act in good faith when it paid Perez less than the amount it owed her under the FLSA. The restaurant could not claim that it relied on the advice of the payroll provider in not paying Perez her proper compensation because it made a conscious effort in the first place to underreport hours to the provider so that her overtime hours would not be reflected on the provider's records. ■

IRS Announces Quarterly Interest Rates

The IRS has announced that the interest rates for the third quarter of 2008 (i.e., the calendar quarter beginning July 1, 2008) will decrease. The rates will drop to:

- 5% (4% in the case of a corporation) for tax overpayments;

- 5% for tax underpayments;
- 7% for large corporate underpayments; and
- 2.5% for the portion of a corporate overpayment exceeding \$10,000 [Rev. Rul. 2008-27, released 6-2-08]. ■



STATE AND LOCAL NEWS

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Alabama

Mandatory electronic UI wage reporting threshold adjusted. Beginning with second quarter 2008 reports, employers with five or more employees (was 25 or more employees) and third-party tax preparers must submit quarterly unemployment insurance (UI) contribution and wage reports electronically (e.g., Internet filing, file transfer upload) to the Department of Industrial Relations (this updates *The Payroll Source*®, p. 7-34). Magnetic media reporting is no longer allowed [Ala. Adm. Code §480-4-2-.32].

California

Same-sex marriage recognized; ballot initiative scheduled. On 5-15-08, the California Supreme Court ruled that laws limiting marriage to opposite-sex couples are unconstitutional. California already allows same-sex couples to register as domestic partners, so the decision may not have a significant effect on employers. A ballot initiative scheduled for the November 2008 election will let voters decide whether to amend the California Constitution to limit marriage to opposite-sex couples. The court decision becomes final on 6-16-08 at 5 p.m. Massachusetts is the only other state that recognizes same-sex marriage [*In re Marriage Cases*, No. S147999, 2008 Cal. LEXIS 5247 (Cal. Sup. Ct., 5-15-08); Judicial Council of California, News Release No. 31, 6-4-08].

Kansas

Mandatory electronic UI filing and payment threshold established. Effective for filings and payments due after 6-30-08, employers with 250 or more employees and third-party administrators with 250 or more client employees must file their quarterly unemployment insurance (UI) wage reports and contribution returns and submit tax payments electronically. For filings and payments due after 6-30-09, the threshold is lowered to 100 employees and client employees, and for filings and payments due after 6-30-10, the threshold is lowered to 50 employees and client employees [H.B. 2771, L. 2008].

New York

Same-sex marriages performed elsewhere recognized. Gov. David Paterson's office has issued a directive instructing state agencies to revise their policy statements, regulations, and laws to allow for recognition of same-sex marriages legally performed elsewhere. Earlier this year, the Supreme Court of New York, Appellate Division, ruled that a same-sex marriage legally performed in Canada was entitled to recognition in New York after an employer refused spousal benefits to a same-sex spouse (*Martinez v. County of Monroe*, No. 1562 CA 06-02591, N.Y. App. Div., 2-1-08). A lawsuit has been filed to stop the directive from being enforced [State of New York Executive Chamber Directive, *Martinez* Decision on Same-Sex Marriages, 5-14-08].

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