



# PAYROLL CURRENTLY

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## Added Week in Pay Period Did Not Violate FLSA

In a Wage-Hour opinion letter, the U.S. Department of Labor (DOL) explains that a school district's policy of adjusting its biweekly pay schedule to include an extra workweek in one payroll period every four years does not violate the minimum wage and overtime provisions of the Fair Labor Standards Act (FLSA) [W-H Op. Ltr. FLSA2008-5 (5-30-08)].

### Scenario

A school district pays its nonexempt employees a biweekly salary. The salary is computed by multiplying the employee's hourly rate of pay by 40, multiplying the result by 52, and then dividing that amount by 26 to arrive at a biweekly salary. For example, an employee paid \$13 per hour receives an annual salary of \$27,040 (\$13 x 40 hours x 52 weeks) and is paid one-twenty-sixth of the amount biweekly (\$1,040). If an employee works hours in excess of 40 hours in a workweek, the district pays the employee 1½ times the employee's hourly rate for those hours.

Every four years, the district must adjust its pay dates by one week so that there will only be 26 pay periods in a fiscal

year. This adjustment results in one pay period covering three workweeks instead of the usual two.

### Ruling

The DOL explains that the FLSA uses a single workweek as its standard, so a salary that covers a period longer than one workweek must be reduced to its workweek equivalent. For example, the biweekly salary of \$1,040 in the example above results in \$520 of weekly pay. During the pay period containing three workweeks, the \$1,040 paid results in weekly pay amounts of \$346.67 (\$1,040 divided by three workweeks). The regular rate during the three-workweek pay period is \$8.67 per hour (\$346.67 divided by 40 hours). This pay schedule for nonovertime workweeks complies with the FLSA because the corresponding regular rate of \$8.67 per hour exceeds the federal minimum wage. For overtime workweeks, the pay schedule also complies with the FLSA because employees receive at least 1½ times their regular rate for hours worked in excess of 40 in a workweek. ■

## Interest-Free Tax Adjustment Permitted in Worker Classification Cases, IRS Says

In a legal memorandum, the IRS has concluded that an employer is eligible to make an interest-free adjustment to pay its employee FICA tax and federal income tax withholding liability for prior years, as determined under IRC §3509, when the employer is reclassifying a worker following receipt of a determination letter from the Service regarding the worker's classification as an employee

[ILM 200825043, 5-13-08; [www.irs.gov/pub/irs-wd/0825043.pdf](http://www.irs.gov/pub/irs-wd/0825043.pdf)].

### Form SS-8 process

Either a worker or a firm may file a Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to request a determination letter regarding a worker's status for federal

## Payroll Solutions

**Q.** In 2007, one of our employees quit, worked somewhere else for a couple of months, then returned to work for us in a different office. This year, the employee received two 2007 Forms W-2 from us under the company's EIN (employer identification number). We have just discovered that one W-2 overstated her social security wages. How do I file a Form W-2c to correct this mistake?

**A.** If an employee has received more than one Form W-2 from an employer under the same EIN and one of the forms must be corrected, the employer can either (1) consider all the Forms W-2 for the employee when determining what to enter on Form W-2c; or (2) file a Form W-2c to correct one of the multiple Forms W-2 issued to the employee (see *The Payroll Source*®, p. 8-77).

**EXAMPLE:** An employer issued two Forms W-2 to an employee using the same EIN. One form incorrectly reported social security wages totaling \$30,000, instead of the correct figure of \$25,000. The other form correctly reported social security wages of \$20,000. Using the first approach, the employer may file a single Form W-2c that would show "50000.00" in Box 3 under "Previously reported" and "45000.00" in Box 3 under "Correct information." Using the second approach, the employer may address only the incorrect Form W-2 by filing a Form W-2c that shows "30000.00" in Box 3 under "Previously reported" and "25000.00" in Box 3 under "Correct information."

employment tax purposes. If the firm is determined to be the employer of the worker, it will generally be liable for the resulting underpayment of employment taxes. At any time, including throughout the determination process, the firm may reclassify a worker as an employee and resolve any resulting employment tax liability.

IRS SS-8 Units provide assistance to employers on how to comply with any such determination. The units requested guidance on the applicability of IRC §§ 3509 and 6205 to the Form SS-8 determination process. They asked whether both sections are available to calculate and pay the taxes when an employer reclassifies a worker as an employee after receiving a determination letter from the Service indicating that the worker is an employee.

### IRC §3509

IRC §3509 provides reduced rates for certain employment taxes when a worker is reclassified as an employee. An employer must meet several requirements to be eligible to apply these rates.

Nothing in the statute or legislative history of §3509 limits the availability of the special rates to circumstances where a worker misclassification is determined pursuant to an IRS examination. Furthermore, the legislative history indicates that §3509 was enacted in part to facilitate compliance by simplifying procedures. "Allowing employers to determine employment tax liability using §3509 rates following an SS-8 determination to correct underpayments will encourage compliance" with the determination.

The IRS explains that §3509 was intended to calculate only prior year liabilities. The need for simplification arises

only when the calendar year is over because there is no further opportunity to withhold the income tax for the calendar year and the employee may have already paid self-employment tax. Moreover, until the year is over and the employer does or does not issue an information return to the worker (e.g., Form 1099-MISC), it cannot be determined whether the employer met the qualifications for §3509 and which rates apply.

### IRC §6205

IRC §6205 permits employers to correct their employment tax underpayments without incurring any interest if the error is timely reported and the tax is timely paid. The regulations provide for interest-free adjustment of federal income tax withholding for wages paid in prior calendar years only on supplemental returns. Currently, only forms used in an examination context are supplemental returns. The supplemental return provision in the §6205 regulations would have a broader effect if the Service provided a supplemental return process outside the examination context.

### Conclusion

There are no direct tax effects for the reclassified employees when an employer makes adjustments using §3509 rates. Accordingly, interest-free adjustments should be permitted for employers using those rates.

If an employer satisfies the requirements of §3509, the employer may use §3509 to determine the employee FICA tax and federal income tax withholding liability for prior years when the employer is reclassifying a worker following receipt of a determination letter from the Service regarding the worker's classification as an employee. ■

## Shoes Required by Employer Were Not a Uniform

In a Wage-Hour opinion letter, the U.S. Department of Labor (DOL) advises an employer that the "dark colored" footwear it requires its employees to wear is not a "uniform" under the Fair Labor Standards Act (FLSA). Moreover, the employees' voluntary assignment of wages to the employer for the purchase of the shoes is not an impermissible deduction from wages [W-H Op. Ltr. FLSA2008-4 (5-15-08)].

### Background

The employer operates restaurants and requires employees to wear "dark-colored" shoes without prescribing any particular quality, brand, style, model, or type. The required shoes cannot be open-toed and must not have a slippery sole. Employees may wear shoes they already own that meet these requirements, or they may purchase the shoes

from a vendor of their choice. Employees can wear the shoes outside of work.

The employer has arranged to allow employees to purchase their shoes from a shoe vendor. An employee purchasing shoes from the vendor may either pay the vendor directly or can arrange for the employer to pay the vendor and have the shoe purchase deducted from the employee's paycheck over a number of weeks. Paycheck deductions for the shoe purchases may cause the remaining amount of the employee's paycheck to fall below the minimum wage for the hours worked during that pay period.

### Analysis

The DOL explains that the cost to employees of uniforms may not result in wages falling below the legally required minimum.

Whether certain articles of clothing an employer requires an employee to wear at work are a uniform must be considered in the context of each particular case. Here, the shoes required by the employer appear to be ordinary footwear. The fact that they must be “dark-colored” and have a non-slip sole does not make them a “uniform” under the FLSA. The employer therefore is not responsible for the cost of the shoes.

Under the FLSA (29 USC §203(m)), “wages” paid to an employee include the “reasonable cost” to the employer of furnishing the employee with board, lodging, or other facilities. Reasonable cost is not more than the actual cost to the employer of the board, lodging, and other facilities

customarily furnished to the employee.

Here, the DOL said the purchase of the shoes was the furnishing of “other facilities” by the employer, so a deduction for the actual cost of the shoes could be taken, even if it reduced the amount of the employee’s cash wages below the minimum wage, so long as the employer did not profit or include any administrative costs. The payroll deduction here was permissible because it was made simply to recoup the actual cost incurred by the employer. Finally, the DOL points out that the reasonable cost of other facilities may be credited toward an employee’s wages even if the employee is a tipped employee. ■

## IRS Issues Proposed Regulations on Health Savings Accounts

The IRS has issued proposed regulations on employer comparable contributions to health savings accounts (HSAs) under IRC §4980G, as amended by the Tax Relief and Health Care Act of 2006 (see *PAYROLL CURRENTLY*, Issue No. 26, Vol. 14) [73 F.R. 40793, 7-16-08; <http://edocket.access.gpo.gov/2008/pdf/E8-16175.pdf>].

**The Tax Relief and Health Care Act of 2006.** The Act permits one-time rollover contributions to HSAs from health reimbursement accounts (HRAs), health flexible spending arrangements (FSAs), and individual retirement accounts (IRAs). Transfers must be made by January 1, 2012.

**Comparable contributions in general.** An employer is not required to contribute to the HSAs of its employees. However, in general, if an employer makes contributions to any employee’s HSA, then the employer must make comparable contributions to the HSAs of all comparable participating employees. Comparable participating employees are eligible individuals who have the same category of high deductible health plan (HDHP) coverage – i.e., self-only or family coverage.

### Proposed regulations

**Special rule for contributions to non-highly compensated employees.** Under the proposed regulations, employer contributions to the HSAs of non-highly compensated employees may be larger than employer contributions to the HSAs of highly compensated employees with comparable coverage during a period. Conversely, employer contributions to the HSAs of highly compensated employees may not exceed employer contributions to the HSAs of non-highly compensated employees with comparable coverage during a period.

The comparability rules still apply with respect to contributions to the HSAs of all non-highly compensated employees who are comparable participating employees (i.e., eligible individuals who are in the same category of employees with the same category of high deductible health plan). Therefore, the employer must make comparable contributions to the HSA of each non-highly compensated employee who is a comparable participating employee during the calendar year.

A highly compensated employee is defined as any employee who was:

- a 5% owner at any time during the year or the preceding year; or
- for the preceding year,
  - had compensation from the employer in excess of \$105,000 (for 2008, indexed for inflation) and
  - if elected by the employer, was in the group consisting of the top 20% of employees when ranked based on compensation.

**Maximum HSA contribution for mid-year eligible individuals.** The Tax Relief and Health Care Act of 2006 provides

that during the last month of the tax year, eligible individuals may make or have made on their behalf the maximum annual HSA contribution based on their HDHP coverage. Under the proposed regulations, the employer can contribute up to this maximum contribution on behalf of all employees who are eligible individuals during the last month of the tax year – including employees who become eligible individuals after January 1st and eligible individuals who are hired after January 1st (“mid-year eligible individuals”).

**Special rules for qualified HSA distributions.** A “qualified HSA distribution” is a direct distribution of an amount from a health FSA or an HRA to an HSA. Under the proposed regulations, if an employer offers qualified HSA distributions to any employee who is an eligible individual covered under any HDHP, then the employer must offer qualified HSA distributions to all employees who are eligible individuals covered under any HDHP. However, an employer that offers qualified HSA distributions only to employees who are eligible individuals covered under the employer’s HDHP is not required to offer qualified HSA distributions to employees who are eligible individuals but are not covered under the employer’s HDHP.

### Effective date

The regulations are proposed to apply to employer contributions made on or after the first day of the first calendar year after the final regulations are published in the Federal Register. However, taxpayers may rely on the proposed regulations with respect to employer contributions made on or after January 1, 2007.

### Comments

Comments on the proposed regulations must be received by October 14, 2008. Send written comments to: CC:PA:LDP:PR, Internal Revenue Service, Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: [www.regulations.gov](http://www.regulations.gov). Be sure to reference IRS REG-120476-07.

### Notices 2008-51, 2008-52, 2008-59

The IRS has released additional guidance on the HSA rule changes made by the Tax Relief and Health Care Act of 2006:

- Notice 2008-51 [2008-25 IRB 1163; [www.irs.gov/irb/2008-25\\_IRB/ar09.html](http://www.irs.gov/irb/2008-25_IRB/ar09.html)] discusses contributions to an HSA from an individual’s IRA or Roth IRA.
- Notice 2008-52 [2008-25 IRB 1166; [www.irs.gov/irb/2008-25\\_IRB/ar10.html](http://www.irs.gov/irb/2008-25_IRB/ar10.html)] discusses contribution amounts for part-year participants.
- Notice 2008-59 [2008-29 IRB 123; [www.irs.gov/irb/2008-29\\_IRB/ar11.html](http://www.irs.gov/irb/2008-29_IRB/ar11.html)] offers over 40 new frequently asked questions and answers on HSAs. ■

## IRS Announces Quarterly Interest Rates

The IRS has announced that the interest rates for the fourth quarter of 2008 (i.e., the calendar quarter beginning October 1, 2008) will increase. The rates will increase to:

- 6% (5% in the case of a corporation) for tax overpayments;

- 6% for tax underpayments;
- 8% for large corporate underpayments; and
- 3.5% for the portion of a corporate overpayment exceeding \$10,000 [Rev. Rul. 2008-47, released 8-28-08]. ■

## Wage & Hour Roundup

The U.S. Department of Labor's Wage & Hour Division recently concluded the following Fair Labor Standards Act (FLSA) enforcement actions:

### Misclassification: overtime

The Code Enforcement Division of the city of Fort Worth, Texas, has paid \$220,521 in back overtime wages to 79 current and former employees. The Division's responsibilities include performing inspections and investigating complaints concerning dangerous or substandard structures, as well as tagging and towing junked motor vehicles. W-H investigators found that the city violated FLSA overtime provisions by misclassifying Division employees as exempt from the law and failing to pay overtime to those who worked more than 40 hours in a workweek.

### Nonexempt salaried workers: overtime

EMIT Technologies, Inc., of Sheridan, Wyoming, a manufacturer and installer of electronic equipment, has paid \$79,641 in back overtime wages to 10 employees. The company failed to pay nonexempt salaried workers overtime, and did not include incentive pay in the regular rate of pay when overtime was calculated.

### Public agency employees: overtime and compensatory time

Florida A&M University in Tallahassee has agreed to pay \$272,988 in back overtime wages to 352 employees. W-H investigators found that the school failed to total the hours when employees worked in different departments or jobs during a workweek, so that some employees did not receive credit for overtime when their total hours exceeded 40 in a workweek. In addition, employees were awarded

compensatory time on an hourly basis rather than at a rate of 1.5 hours for each hour accrued, and employees were allowed to accrue in excess of 240 hours of compensatory time in a leave year.

### Pre-shift time: compensable time

Hospital Shared Services, Inc., of Denver, Colorado, provides security guard services to area hospitals. The company has agreed to pay \$200,000 in back wages to 1,240 security guard employees. W-H investigators found that the company required these employees to be at their work stations 10 minutes early but failed to compensate them for this time.

### Mandatory training: compensable time

The DOW Chemical Co. in Freeport, Texas, has paid \$861,647 in back overtime wages to 648 operating engineers. W-H investigators found that the company failed to compensate these employees for hours spent studying during mandatory training.

### Deductions from pay: minimum wage violations

Gene's Seafood of Jacksonville, Florida, has agreed to pay \$56,187 in back wages to 61 restaurant employees. W-H investigators found that full-time employees were paid overtime at straight time rates, and that part-time employees were paid cash and not listed on the restaurant's payroll records. In addition, the company made deductions from employees' pay for a variety of reasons – including breakage, shortages, uniform purchases, and errors in customer orders – that caused some employees to be paid below the federal minimum wage. ■

## Missouri Enacts Tough Immigration Law

On July 7, 2008, Missouri Governor Matt Blunt signed what he described as "some of the strongest legislation in the country to fight illegal immigration." Several provisions in the new law will affect employers [H.B. 1549, L. 2008; Office of the Governor, Press Release, 7-8-08].

### Provisions effective January 1, 2009

**General prohibition on employment of unauthorized aliens.** Effective January 1, 2009, employers are prohibited from knowingly employing, hiring for employment, or continuing to employ unauthorized aliens to perform work in Missouri. An "employer" is defined as any person or entity employing any person for hire within Missouri, including a public employer. An "employee" means any person performing work or service of any kind or character for hire within Missouri.

**Mandatory participation in federal work authorization program.** Effective January 1, 2009, as a condition for the award of any contract or grant in excess of \$5,000 by the state or a political subdivision to a business entity, or for any business entity receiving a state tax credit, tax abatement, or loan, the business entity must affirm its enrollment and participation in a federal work authorization program (e.g.,

E-Verify) with respect to the employees working in connection with the contracted services.

Also effective January 1, 2009, all public employers must enroll and actively participate in a federal work authorization program. A private employer may enroll and participate in a federal work authorization program. Any business entity that participates in such a program will have an affirmative defense that it has not violated the prohibition against employing unauthorized aliens.

### Penalties.

- For a first violation, the employer's business permit and any applicable licenses or exemptions will be suspended for 14 days. For a second violation, suspension will be for one year. For a subsequent violation, suspension will be permanent.

- In addition, any business entity awarded a state contract or grant or receiving a state tax credit, tax abatement, or loan will be deemed in breach of contract for a first violation and the state may terminate the contract, suspend the entity's right to do business with the state for three years, and withhold up to 25% of the total amount due to the business entity. For a second or subsequent violation, the state may permanently suspend the entity's right to do business with the state.

### Provisions effective August 28, 2008

**Worker misclassification.** Effective August 28, 2008, an employer knowingly misclassifies a worker if the employer fails to claim the worker as an employee but knows that the worker is an employee. If a court determines that an employer has knowingly misclassified a worker, the court will enter a judgment in favor of the state and award penalties in the amount of \$50 per day per misclassified worker up to a maximum of \$50,000.

**Form 1099-MISC.** Effective August 28, 2008, every

employer doing business in Missouri that employs five or more employees must, if applicable, submit federal Form 1099-MISC, *Miscellaneous Income*, to the Missouri Department of Revenue within the timeframe established for filing state Form MO-99 MISC, *Information Return for Receipts of Miscellaneous Income* (i.e., last day of February). An employer that intentionally fails to submit information returns as required will be fined up to \$200 for each violation, beginning with the fifth occurrence. ■

## Court Rejects IRS Position That Medical Residents Do Not Qualify for the FICA Student Exception

In 2007, the Eleventh Circuit Court of Appeals ruled that the determination of whether medical residents can qualify for the student FICA exception must be made on a case-by-case basis and remanded a lawsuit filed by the Mount Sinai Medical Center of Florida, Inc., for further consideration (see **PAYROLL CURRENTLY, Issue No. 12, Vol. 15**). A federal district court in Florida has now decided that the student FICA exception applied to the residents in Mount Sinai's graduate medical education program and ordered the IRS to refund more than \$3 million in FICA taxes [*U.S. v. Mt. Sinai Medical Ctr. of Fla., Inc.*, No. 02-22714-CIV-GOLD, 2008 U.S. Dist. LEXIS 57808 (SD Fla., 7-28-08)].

### The student exception from FICA tax

The Federal Insurance Contributions Act (FICA), which provides that FICA taxes must be paid on "all remuneration for employment," excludes several categories of "service" from "employment," including service performed in the employ of a "school, college, or university" (SCU) if such service is performed by a student who is enrolled and regularly attending classes at such SCU (26 USC §3121(b)(10)).

IRS regulations in effect for tax years 1996 to 1999, the years at issue here, implemented the exception by providing that the term "school, college, or university" was to be "taken in its commonly or generally accepted sense" (26 C.F.R. §31.3121(b)(10)-2). *Note:* The court said that the 2005 version of the regulations did not apply in this case.

### The medical center was a school

The court said that Mount Sinai, a private, independent, not-for-profit teaching hospital, was the residents' employer and was a school for purposes of the student FICA exception.

The fact that Mount Sinai did not identify or refer to itself as a "school" was not important. Nor did it matter that Mount Sinai did not grant formal academic degrees (although residents and fellows did receive certificates of completion). What was significant, said the court, was that Mount Sinai's residency programs were organized and operated as an SCU.

Mount Sinai was one of only six teaching hospitals in Florida. Patient care was an integral and appropriate part of a resident's education, an experience that could not be replicated by watching a video or attending a lecture. Mount Sinai also had typical school facilities and resources, including a medical library, laboratories, classrooms, and lecture halls.

The court rejected the government's argument that Mount Sinai was not an SCU because the purpose of its program was to make money rather than educate doctors. Mount Sinai could have provided patient care more cost-efficiently without residents because of the time and effort required to supervise and teach them.

### The residents were students

All residents admitted to the residency program had to undergo an application and admissions process similar to an SCU. Admission was based on merit, educational achievement, letters of recommendation, etc. Accordingly, applicants to Mount Sinai's residency program were "enrolled."

A "class" in the context of medical education is different from traditional "lecture only" schooling. Residents do not fully learn how to safely perform medical procedures on patients until after they have completed their residency program.

Each of Mount Sinai's 12 residency programs had an established curriculum in which resident participation was mandatory. Although residents did not register for credit hours, program directors ensured that subject matter areas were addressed through mandatory rotations. Residency programs featured mandatory attendance at lectures and conferences. Resident performance was monitored through regular evaluations, quizzes, and tests. By participating in these activities, residents "regularly attended classes."

The primary purpose of the residency programs was educational because the programs were designed to give residents the knowledge and skill to practice a medical specialty. Mount Sinai did not "hire" the residents; they applied to, and enrolled in, residency programs with highly structured curricula. Residents were subject to the program curricula and the supervision of the faculty and Mount Sinai. Completion of a residency program was a prerequisite for sitting for a specialty certification exam. The residents had no expectation of continued employment following their residencies. The fact that some residents earned extra money by "moonlighting" did not change the educational nature of the residency programs because Mount Sinai did not give credit for time spent moonlighting or for patients seen by residents while moonlighting. Finally, former residents testified that their purpose in enrolling was educational. ■

## IRS Issues Proposed Regulations on Disaster Relief

The IRS has issued proposed regulations implementing the Victims of Terrorism Relief Act (Pub. L. No. 107-134), and clarifying the rules on the postponement of certain tax-related acts (e.g., filing tax returns, paying taxes, or filing a claim for credit or refund of tax) because of a Presidentially declared

disaster or terroristic or military action in light of current IRS practice [73 F.R. 40471, 7-15-08; <http://edocket.access.gpo.gov/2008/pdf/E8-15939.pdf>].

Under the proposed regulations, the period of time the Secretary of the Treasury may postpone certain tax-related

acts has been increased from 90 days to one year. Additionally, the Secretary is authorized to suspend interest, penalties, additional amounts, and additions to tax that would normally accrue during the time the tax-related act is postponed.

The proposed regulations set forth how the IRS generally implements postponements of time. The regulations also provide that the IRS may grant further relief to taxpayers by revenue ruling, revenue procedure, notice, announcement, news release, or other guidance published in the Internal Revenue Bulletin in addition to the relief provided by the proposed regulations.

Although specific tax-related acts may be due on different dates within the postponement period, the acts may be postponed until the last day of the period. And when an affected taxpayer is required to perform a tax-related act by a due date that falls within the postponement period, the taxpayer is entitled to postponement of the act and is eligible for relief from interest, penalties, additional amounts, and additions to tax during the postponement period.

The proposed regulations provide that the postponement period runs concurrently with extensions of time to file or pay, if any. For example, when the original due date falls within the postponement period, an affected taxpayer has until the last day of the postponement period to file for an extension of time to file or pay, but any resulting extension runs from the original due date.

The proposed regulations provide that, where the extended due date, but not the original due date, falls within the postponement period, relief is specific to the type of extension received. For example, an affected taxpayer who received an extension of time to file, but not an extension of time to pay, is eligible for a postponement of time to file and relief from penalties relating to the failure to file. The taxpayer is not eligible for penalty and interest relief relating to the failure to pay, as the payment due date was not extended.

The proposed regulations clarify that a postponement of time to perform a tax-related act does not extend the due date to perform the act, but instead merely allows the IRS to disregard a time period of up to one year for performance of the act.

#### **Effective date**

The proposed regulations will apply to Presidentially declared disasters or terroristic or military actions occurring on or after the date they are published as final regulations in the Federal Register.

#### **Comments**

Comments on the proposed regulations must be received by October 14, 2008. Send written comments to: CC:PA:LPD:PR, Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: [www.regulations.gov](http://www.regulations.gov). Be sure to reference IRS REG-142680-06. ■

## **Update on Income Tax Treaties**

The U.S. has income tax treaties with nearly 60 countries. Income tax treaties may exempt or reduce the amount of withholding from wages earned by nonresident aliens in the U.S. if certain conditions are met (see *The Payroll Source*®, pp. 14-17 and 14-18 for additional discussion of income tax treaties). Since PAYROLL CURRENTLY last reported on the subject (see *Issue No. 16, Vol. 15*), a new income tax treaty with Belgium has entered into force, along with protocols amending existing income tax treaties with Denmark, Finland, and Germany. In addition, treaty protocols with Bulgaria, Canada, and Iceland have been transmitted to the Senate for ratification.

### **Treaty and protocols enter into force**

On December 28, 2007, a new income tax treaty with Belgium and tax protocols with Denmark, Finland, and Germany entered into force. All of the agreements generally apply to tax years beginning on or after January 1, 2008. Certain provisions in the protocols with Finland and Germany are effective on or after January 1, 2007.

**U.S.-Belgium.** The U.S. and Belgium signed a new income tax treaty on November 27, 2006, to replace an existing treaty. The new treaty was approved by the U.S. Senate on December 14, 2007. It significantly reduces tax-related barriers to trade and investment between the U.S. and Belgium, and takes into account changes in the laws and policies of both countries since the previous treaty was signed.

For example, it eliminates source-country withholding tax on dividends arising from certain direct investments and on dividends paid to pension funds. Provisions have been added governing contributions to, and benefit accruals of, pension plans to remove barriers to the flow of personal services between the two countries. Students, teachers, business trainees, and researchers from one country visiting the other country are generally exempt from the other country's

taxation on certain types of payments. The agreement is the second signed by the U.S. to provide for mandatory arbitration of certain disputes that cannot be resolved by the competent authorities of the two countries within a specified period of time. It also includes stronger provisions to prevent treaty shopping (the inappropriate use of a tax treaty by third-country residents) and provisions to improve the exchange of information between the two countries.

**U.S.-Denmark.** A protocol amending the existing tax treaty between the U.S. and Denmark was ratified by the Senate on November 16, 2007. It allows the U.S. to tax a former citizen or former long-term resident under IRC §877 (i.e., for 10 years following the loss of such status) regardless of whether a principal purpose of the termination of citizenship or residency was to avoid tax. It provides for elimination of source-country withholding tax on dividends arising from certain direct investments and on dividends paid to pension funds. There are also new anti-treaty-shopping provisions.

**U.S.-Finland.** A protocol amending the existing tax treaty between the U.S. and Finland was ratified by the Senate on November 16, 2007. Like the Denmark protocol, it allows the U.S. to tax a former citizen or former long-term resident under IRC §877 regardless of whether a principal purpose of the termination of citizenship or residency was to avoid tax. It provides for elimination of source-country withholding tax on dividends arising from certain direct investments and on dividends paid to pension funds. It also provides for the elimination of cross-border royalty payments and includes new anti-treaty-shopping provisions.

**U.S.-Germany.** A protocol amending the tax treaty between the U.S. and Germany was ratified by the Senate on December 14, 2007. It incorporates changes in the laws and policies of the two countries since the treaty was negotiated, including changes involving relief from double taxation. This

is the first protocol to incorporate a provision directing the mandatory arbitration of certain disputes that cannot be resolved within a certain time by the treaty's competent authorities.

The protocol also allows the U.S. to tax a former citizen or former long-term resident under IRC §877 regardless of whether a principal purpose of the termination of citizenship or residency was to avoid tax. It treats the income derived from independent personal services (such as income from the performance of professional services) as "business profits" and eliminates the treaty article governing independent personal services.

It eliminates source-country withholding tax on dividends arising from certain direct investments and on dividends paid to pension funds. It also provides that pensions and other similar remuneration paid in consideration of past employment as well as benefits paid under the social security legislation of one country are taxable only in the country of which the recipient is a resident, based on the social security legislation.

The provision governing visiting professors and teachers, and students and trainees, increases the exemption from host country tax for students and trainees receiving certain types of payments, and provides that professors or teachers from one country visiting the other country for more than two years do not retroactively lose their exemption from the host country's income tax. There are also updated anti-treaty-shopping provisions.

#### **Treaties and protocols awaiting Senate ratification**

**U.S.-Bulgaria.** On February 23, 2007, the U.S. and Bulgaria signed their first income tax treaty and protocol, the result of negotiations begun in 2005. On February 26, 2008, the two countries signed another protocol making technical corrections to the treaty. The President transmitted the treaty and protocols to the Senate on June 4, 2008. On July 29, 2008, the Senate Foreign Relations Committee favorably reported the treaty and protocols for consideration by the full Senate.

In general, the agreements require Bulgaria to exempt the income of a resident of Bulgaria from its income tax if the income may be taxed in the U.S., while the U.S. is required to provide a credit against its income tax to a U.S. resident for income tax paid or accrued to Bulgaria. The agreements reduce, but do not eliminate, the rates of taxation on cross-border dividends, interest, and royalty payments, and generally eliminate withholding when cross-border dividends are paid to pension funds, and when cross-border interest is paid to the government of the other country or to a financial institution resident in the other country. Like the agreement negotiated by the U.S. with Belgium, this agreement has provisions designed to prevent treaty shopping, which is the inappropriate use of a tax treaty by third-country residents, as well as provisions to improve the exchange of information.

**U.S.-Canada.** On September 21, 2007, the U.S. and Canada signed a protocol updating their existing income tax treaty, which dates from 1980. The protocol is the fifth update to this treaty. On March 13, 2008, the President transmitted the protocol to the Senate, and on July 29, 2008, the Senate Foreign Relations Committee favorably reported the protocol for consideration by the full Senate.

The protocol eliminates source-country withholding tax on cross-border interest payments and clarifies the treatment of stock options. It also extends treaty benefits to limited liability companies. Provisions of the existing treaty governing pensions and annuities are modified to address cross-border

pension contributions and benefit accruals, as well as Roth individual retirement accounts.

Finally, the protocol provides for the arbitration of double-taxation issues – the third agreement by the U.S. to do so. As with the arbitration provisions in the agreements with Belgium and Germany, the "last best offer" by the competent authority of each country would be presented to an arbitrator, who would have to select one of the figures presented in order to settle the dispute.

**U.S.-Iceland.** On October 23, 2007, the U.S. and Iceland signed a new income tax treaty to replace the 1975 treaty between the two countries. The agreement was transmitted to the Senate by the President on June 4, 2008, and on July 29, 2008, the Senate Foreign Relations Committee favorably reported the replacement treaty for consideration by the full Senate.

The replacement treaty takes into account changes in the law and policies of both countries since the current treaty was signed. For example, it provides for a positive rate of withholding on certain cross-border royalty payments, in conformity with Iceland's current tax treaty policy. To conform to the current tax treaty policy of the U.S., the replacement treaty has a comprehensive limitation of benefits provision so that only residents satisfying the conditions of that paragraph enjoy the benefits of the treaty.

**U.S.-Malta.** On August 8, 2008, the U.S. and Malta signed an income tax treaty, the first between the two countries. The agreement provides for reduced withholding rates on cross-border dividend payments, generally eliminates withholding on cross-border dividend payments to pension funds, and provides for withholding at 10% on interest, royalties, and other income. The treaty also contains a comprehensive limitation of benefits provision and provides for the exchange of information between the competent authorities to facilitate the administration of each country's tax laws.

#### **Treaty negotiations underway**

Negotiations between the U.S. and New Zealand have begun for a protocol that would amend the existing income tax treaty between the two countries that entered into force in 1983. Discussions are being conducted with Hungary and Poland for the inclusion of anti-treaty shopping provisions in the agreements with those countries. Finally, the Treasury Department reports that negotiations with several countries in Asia and South America may begin later in 2008 or 2009.

#### **Information about tax treaties**

- Detailed summaries of the individual tax treaties currently in force between the U.S. and other countries can be found in the APA's *Guide to Global Payroll Management* (see [www.americanpayroll.org/publication/](http://www.americanpayroll.org/publication/)).

- IRS Publication 515 (*Withholding of Tax on Nonresident Aliens and Foreign Entities*) contains general tax treaty information, as well as a table of tax treaties providing information about tax exemptions for nonresident aliens. Publications 901 (*U.S. Tax Treaties*) and 597 (*Information on the U.S.-Canada Income Tax Treaty*) contain more detailed explanations. Form 6166 is a letter of U.S. residency certification for purposes of claiming benefits under an income tax treaty.

All of these materials, plus tax treaties and proposed treaty documents themselves, and the 2006 Model Convention (together with a technical explanation) can be found on the IRS website at [www.irs.gov/businesses/international/article/0,,id=96739,00.html](http://www.irs.gov/businesses/international/article/0,,id=96739,00.html). ■



## STATE AND LOCAL NEWS

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### Alaska

**Paycards permitted, conditions for use defined.** Employers may use debit cards or electronic paycards as a method of compensating employees for wages earned. According to an official with the Department of Labor and Workforce Development (DLWD), this method is acceptable so long as it is voluntary and employees can access their entire paycheck at least once each pay period without paying a fee [DLWD Labor Standards and Safety Division, Letter to APA, 8-5-08].

### California

**Pay frequency for temporary service employees established.** Effective 1-1-09, temporary service employers must pay employees at least weekly. Wages for work performed during any calendar week are due and payable not later than the regular payday of the following calendar week. Wages are due daily if an employee is assigned to work: (1) on a day-to-day basis for a client and the employee is not performing executive, administrative, professional, or clerical functions; or (2) for a client engaged in a trade dispute. These requirements do not apply to employees who are assigned to work for a client for over 90 consecutive days unless the employer pays the employee weekly. A "temporary service employer" is defined as an employing unit that contracts with clients to supply workers to perform services for clients. Also, temporary service employers must perform specific functions, which include, among others, assigning and or reassigning workers to clients, paying and setting workers' pay rates, and retaining the right to hire and fire workers [S.B. 940, L. 2008].

### Maine

**Mandatory electronic filing of withholding returns: threshold established.** Effective for income tax withholding returns filed for calendar year 2008, employers with 75 or more employees and third-party filers or payroll processors preparing returns for employers with 75 or more employees must electronically file quarterly returns and annual reconciliation returns. For returns filed in calendar year 2009 and beyond, the threshold is lowered to 50 employees. Employers may request, in writing, a waiver of the requirement to file electronically that clearly indicates the tax type for which the waiver is requested, why the requirement will cause the employer undue hardship, and the date by which the employer intends to be in compliance [Code Me. R. 18-125-104].

### New York

**Layoff notice requirement established.** Effective 2-1-09, employers with 50 or more full-time employees will be required to give written notice to affected employees 90 days before ordering a mass layoff, relocation, or employment loss. Notice will not be required if the mass layoff, relocation, or employment loss is due to a physical calamity or an act of terrorism or war. Employers that fail to provide notice will be required to provide back pay to each employee who was entitled to receive notice at the average regular rate of pay received by the employee during the last three years of his or her employment or the employee's final rate of pay, whichever is higher. Employers must also provide the value of the cost of any benefits to which the employee would have been entitled had his or her employment not been lost, including the cost of any medical expenses incurred by the employee that would have been covered under an employee benefit plan. Penalties will be calculated for the period of the employer's violation up to a maximum of 60 days or half the number of days that the employee was employed by the employer, whichever is smaller. Employer penalties may be reduced by a number of factors, including whether the employer pays wages to the affected employees during the period of the violation [S.B. 8212, L. 2008].

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