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Capitol Hill Update

The following are some recent payroll-related legislative developments. All information is current through October 1, 2008. *Note:* Except as noted, the status of legislation discussed in PAYROLL CURRENTLY, Issue Nos. 5, 10, and 14, Vol. 16, is unchanged.

Michelle's Law: group health plan coverage of a college-age dependent child

H.R. 2851, approved by the House of Representatives on July 30, 2008, and the Senate on September 25, 2008, has been presented to the President for his signature. Applicable to plan years beginning one year after the date of enactment, it amends existing laws (e.g., ERISA, IRC) to prohibit a group health plan from terminating coverage of a dependent child due to a medically necessary leave of absence from a "postsecondary educational institution," or any other change in enrollment at that institution that:

- commences while such child is suffering from a serious illness or injury;
- is medically necessary (written certification by the child's physician is required); and
- causes such child to lose student status for purposes of coverage under the terms of the plan or coverage before the earlier of:
 - one year after the first day of the medically

necessary leave of absence, or

- the date on which such coverage would otherwise terminate under the terms of the plan.

Comprehensive American Energy Security and Consumer Protection Act: bicycle commuters

H.R. 6899 was passed by the House of Representatives (236-189) on September 16, 2008. It has been transmitted to the Senate for consideration. The bill includes a provision to add a "qualified bicycle commuting reimbursement" fringe benefit of up to \$20 a month that appeared previously in H.R. 5351 (see [PAYROLL CURRENTLY, Issue No. 5, Vol. 16](#)). It also includes a provision that would require federal agencies to offer transit pass transportation fringe benefits to their employees nationwide.

Electronic pay stubs for federal employees

H.R. 6073 provides that federal employees receiving their pay by electronic funds transfer would be given the option of receiving their pay stubs electronically (see [PAYROLL CURRENTLY, Issue No. 14, Vol. 16](#)). On July 31, 2008, it was approved by a voice vote in the House of Representatives and sent to the Senate, where it was referred to the Committee on Homeland Security and Governmental Affairs. On September 23, 2008, the Committee approved the bill and sent it to the floor, where it is now ready to be voted on.

Payroll Solutions

Q. Our company would like to set up a plan to enable employees to contribute money to a company savings program. The company would also contribute to the plan on behalf of participating employees. Can the plan be structured so that the company's contributions to nonexempt employees would not count in overtime calculations under the Fair Labor Standards Act (FLSA)?

A. Yes. Under the FLSA (29 USC §207(e)(3)), an employee's regular rate of pay does not include payments made pursuant to a "bona fide thrift or savings plan." The plan must meet the following requirements (29 C.F.R. §§547.1, 547.2):

- The plan must be in writing.
- The plan must be established and maintained to encourage employee savings by providing an incentive to regularly accumulate and retain cash savings for a reasonable time, or to save through the regular purchase of public or private securities.
- The plan must set out the categories of employees eligible to participate and the criteria for their eligibility. Although eligibility may not be based on such factors as hours of work, production, or efficiency of the employees, hours of work can be used to determine the eligibility of part-time or casual employees.
- The plan must specify the amount an employee may save using a definite formula, which can be based on straight-time earnings or total earnings, base rate of pay, or length of service.
- In general, the employer's total contribution in any year may not exceed 15% of the participating employees' total earnings during that year and cannot exceed the total amount saved or invested by the participating employees during that year. (The regulations outline criteria for allowing a greater employer contribution.)
- The employer's contributions must be apportioned among the individual employees in accordance with a definite formula or method of calculation specified in the plan based on the amount saved or the time the individual employee retains his or her savings or investment in the plan.
- An employee's share in the plan cannot be reduced because of other remuneration received by the employee. Also, an employee's wages or salary cannot be dependent upon, or influenced by, the existence of the plan or the employer's contributions to the plan.
- Employee participation in the plan must be voluntary.
- An employee's hours of work, production, or efficiency cannot be used to determine the amounts an employee may save or the contributions by the employer.

Note: Payments from a plan that are excludable from an employee's regular rate of pay cannot be credited toward an employer's overtime pay requirements under the FLSA (29 C.F.R. §778.213).

Wellstone-Domenici Mental Health Parity and Addiction Equity Act: group health plans

H.R. 6983 was passed by the House of Representatives (376-47) on September 23, 2008. It has been transmitted to the Senate for consideration.

The bill would amend existing laws (e.g., ERISA, IRC) to require equity in the provision of mental health and substance-related disorder benefits under group health plans.

Disaster Tax Relief Act: charitable standard mileage rate

H.R. 7006 was passed by the House of Representatives (419-4) on September 24, 2008. It has been transmitted to the Senate for consideration.

For use of a passenger automobile after the date of enactment and before January 1, 2012, the bill would provide that the charitable standard mileage rate will not be less than the standard mileage rate used for deducting travel expenses related to medical care (currently 27 cents per mile). As under present law, as an alternative to determining the amount of the charitable deduction using the mileage rate, a taxpayer may determine the amount of the deduction using actual out-of-pocket operating expenses.

Renewable Energy and Job Creation Tax Act: nonqualified deferred compensation

H.R. 7060 was passed by the House of Representatives (257-166)

on September 26, 2008. It has been transmitted to the Senate for consideration.

The bill is an updated version of previous legislation that failed to win the approval of both houses of Congress. It includes three provisions of interest to payroll professionals:

- a provision that appeared previously in H.R. 5351 (see *PAYROLL CURRENTLY, Issue No. 5, Vol. 16*) to add a "qualified bicycle commuting reimbursement" fringe benefit of up to \$20 a month;
- a provision to extend the 0.2% FUTA surtax for one year, through December 31, 2009; and
- a provision that appeared previously in H.R. 6049 (see *PAYROLL CURRENTLY, Issue No. 14, Vol. 16*) to limit the ability to defer service provider (i.e., employee) compensation by providing that *any* compensation (including, for example, stock appreciation rights) deferred under a nonqualified deferred compensation plan of a nonqualified entity (e.g., certain foreign corporations and certain foreign and domestic partnerships) is includable in the service provider's gross income when there is no substantial risk of forfeiture of the right to such compensation. This provision would apply in addition to IRC §409A. ■

Federal 'High-Low' Per Diem Rates Issued

As part of the Revenue Procedure explaining the rules for determining whether an employee's travel expenses have been adequately substantiated, the IRS has released the optional "high-low" per diem rates (i.e., the sum of the lodging and meal and incidental expenses (M&IE) rates) that may be used instead of the General Services Administration's "actual" per

diem rates for travel to locations within the continental U.S. (CONUS; the GSA rates are discussed in *PAYROLL CURRENTLY, Issue No. 17, Vol. 16*), the special federal M&IE per diem rates applicable to the transportation industry, and the per diem rate for incidental expenses (see *The Payroll Source*®, starting at p. 3-47). The updated high-low rates apply for travel undertaken

on or after October 1, 2008 (but see discussion of the transition rule below) [Rev. Proc. 2008-59, 9-25-08; www.americanpayroll.org/members/Forms-Pubs].

High-low rates

The “high” rate increases to \$256 (from \$237) for travel to any high-cost locality, while the “low” rate increases to \$158 (from \$152) for travel to any other locality within CONUS. The amount of the high and low rates that is treated as paid for meals remains \$58 for a high-cost locality and \$45 for any other locality within CONUS.

High-cost localities. The following high-cost localities have a federal per diem rate of \$194 or more for all of the calendar year or the portion of the calendar year specified:

- Phoenix/Scottsdale (1/1 - 4/30) and Sedona (3/1 - 4/30), AZ;
- Napa, San Diego (1/1 - 8/31), San Francisco, Santa Barbara, Santa Monica, and South Lake Tahoe (12/1 - 3/31), CA;
- Aspen (12/1 - 4/30), Crested Butte/Gunnison (12/1 - 3/31), Silverthorne/Breckenridge (12/1 - 4/30), Steamboat Springs (12/1 - 3/31), Telluride (10/1 - 3/31), and Vail (12/1 - 7/31), CO;
- Washington, DC;
- Fort Lauderdale (10/1 - 4/30), Fort Walton Beach/De Funiak Springs (6/1 - 7/31), Key West, Miami (10/1 - 2/28), Naples (2/1 - 3/31), and Palm Beach (12/1 - 4/30), FL;
- Chicago, IL;
- Baltimore, Cambridge/St. Michaels (5/1 - 8/31), Montgomery and Prince George’s Counties, and Ocean City (6/1 - 9/30), MD;
- Boston/Cambridge, Martha’s Vineyard (6/1 - 8/31), and Nantucket (6/1 - 9/30), MA;
- Floral Park/Garden City/Glen Cove/Great Neck/Roslyn, New York City, Saratoga Springs/Schenectady (7/1 - 8/31), and Tarrytown/White Plains/New Rochelle/Yonkers, NY;
- Philadelphia, PA;
- Jamestown/Middletown/Newport (6/1 - 9/30), RI;
- Park City (1/1 - 3/31), UT;
- Arlington and Fairfax Counties, Alexandria, Fairfax, and Falls Church, VA;
- Seattle, WA; and
- Jackson/Pinedale (7/1 - 8/31), WY.

Added. The following localities have been added to the list of high-cost localities: Jackson/Pinedale, WY.

Changed. The portion of the year for which the following are high-cost localities has been changed: Phoenix/Scottsdale, AZ; San Diego, CA; Silverthorne/Breckenridge, Steamboat

Springs, and Vail, CO; Palm Beach, FL; Cambridge/St. Michaels and Ocean City, MD; Martha’s Vineyard and Nantucket, MA; and Jamestown/Middletown/Newport, RI.

Removed. The following localities have been removed from the list of high-cost localities: Palm Springs and Yosemite National Park, CA; Stuart, FL; Incline Village/Crystal Bay/Reno/Sparks, NV; Conway, NH; Providence, RI; Loudon County and Virginia Beach, VA; and Lake Geneva, WI.

Transportation industry rates

The federal M&IE rates for the transportation industry remain at \$52 for any locality of travel within CONUS and \$58 for any locality of travel outside the continental U.S. (OCONUS). These special M&IE rates simplify recordkeeping for employers whose employees routinely travel overnight to many different locations during a single payroll period. To qualify, the transportation must directly involve moving people or goods by airplane, barge, bus, ship, train, or truck, and must regularly require travel away from home on trips among localities with differing M&IE rates.

Transition rule

Revised actual per diem rates, issued by the GSA, also took effect October 1, 2008. An employer that used the GSA rates for an employee during the first nine months of 2008 may not use the high-low substantiation method for that employee until January 1, 2009. Conversely, an employer that used the high-low substantiation method for an employee during the first nine months of 2008 must continue to use that method for the remainder of calendar year 2008 for that employee (and may continue to use the rates and high-cost localities in effect for the first nine months of 2008 for travel between October 1 and December 31, 2008, if those rates and localities are used consistently during this period for all employees reimbursed using this method).

Incidental expenses

Instead of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, an employee or self-employed individual may use an amount computed at the rate of \$3 (unchanged) per day for each calendar day (or partial day) he or she is away from home. This amount will be deemed substantiated provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day). ■

Air Traffic Controllers Were Improperly Compensated With ‘Credit Hours’ for Overtime

In a lawsuit brought by more than 7,000 air traffic controllers seeking overtime pay, the U.S. Court of Federal Claims has ruled that employees of the Federal Aviation Administration (FAA) are covered by the Fair Labor Standards Act (FLSA). Therefore, overtime compensation in the form of “credit hours” was improper [*Abbey v. U.S.*, 2008 U.S. Claims LEXIS 207 (Ct. of Fed. Cl., 7-31-08)].

In 1996, the FAA became subject to its own personnel management system in an effort to provide the agency with “greater flexibility in the hiring, training, compensation and location of personnel” (49 USC §40122(g)(1)). The Administrator of the FAA was not “bound by any requirement to establish ... compensation or benefits at particular levels” (49 USC §106(l)(1)).

Noting that the 1996 legislation did not displace the FLSA

with respect to FAA employees, the court said that the FLSA still applies to them. Moreover, since that legislation exempted the FAA from many personnel laws and regulations in order to allow it to offer wages competitive with the private sector and operate more like a business, abolishing the overtime requirements of the FLSA for FAA employees would not have been consistent with that goal.

Pursuant to collective bargaining agreements negotiated with the air traffic controllers union in 1998 and 2006, the FAA began granting “credit hours” as compensation for hours worked in excess of 40 hours per week. This compensatory scheme violated the FLSA, said the court.

If certain conditions are met, the FLSA permits state and local government employers to give their nonexempt employees one and one-half hours of paid compensatory

time off for each hour of overtime worked rather than paying a premium rate for the overtime (29 USC §207(o)). This provision does not cover federal employees, however. In any case, the FAA's compensatory time scheme provided compensatory time at an hour-for-hour rate for overtime

hours worked rather than the FLSA-mandated rate. And the fact that a collective bargaining agreement allowed the use of compensatory "credit hours" did not matter because the FLSA controls over conflicting provisions in a collective bargaining agreement. ■

TIGTA Issues Report Following Audit of IRS Withholding Compliance Program

In a recently issued report, the Treasury Inspector General for Tax Administration (TIGTA) presents the results of a review of the IRS Withholding Compliance Program. Implemented in fiscal year 2005, the Program analyzes wage and tax information reported on Forms W-2 and tax return data to identify taxpayers who have not had enough taxes withheld and are not compliant with filing and/or paying their taxes. In most cases, the IRS issues notices called "lock-in letters" to both employers and employees (taxpayers), which direct the employers to withhold taxes from their employees' wages at a specified rate.

The report concludes that although lock-in letters have generally improved taxpayer compliance, additional actions are needed to further improve taxpayer withholding compliance and changes are needed to improve the effectiveness of processing referral cases [2008-40-167; www.treas.gov/tigta/auditreports/2008reports/200840167fr.pdf].

Lock-in letters have generally improved taxpayer compliance

The Withholding Compliance Program issued approximately 122,000 lock-in letters in fiscal year 2006 and 132,000 in fiscal year 2007. The letters sent to the employers direct them to withhold taxes from their employees' wages at a specified rate, and the letters sent to the employees inform them of the instructions provided to their employers. If the employees disagree with the IRS lock-in letter rate, they are instructed to contact the IRS and provide supporting information to justify a different withholding rate or to have the lock-in letter withholding rate rescinded.

TIGTA auditors estimate that from tax years 2003 to 2006, the percentage of taxes withheld from wages increased from 2.1% to 14.2%. For those taxpayers who worked for the same employers in tax years 2003 and 2006 (i.e., employers that were issued a lock-in letter), there was an increase in the percentage of withholding as compared to wages from 1.8% to 15.2%. For those same taxpayers who also worked for a new employer in tax year 2006 (i.e., employers that were not issued a lock-in letter), the percentage of withholding to wages with the new employer increased from 1.8% to 13.9%.

TIGTA concludes that lock-in letters appear to have a positive effect on withholding compliance. It estimates that the IRS collected about \$192 million in additional tax withholding for tax year 2006 as a result of the Withholding Compliance Program contacting employers of underwithheld taxpayers.

Lock-in letters also appear to have a positive effect on taxpayer filing and payment compliance. Between tax years 2003 and 2006, the number of taxpayers in the audit sample who were non-filers or who filed balance-due returns and were assessed a failure-to-pay penalty decreased 51%.

Additional actions are needed to further improve taxpayer withholding compliance

Enforcement actions should be taken against employers that do not comply with lock-in letter instructions. TIGTA estimates that 15% of taxpayers who received lock-in letters

in tax year 2003 are still underwithholding taxes because their employers did not comply with the lock-in letter instructions. For tax year 2006, TIGTA estimates that employer liability for underwithheld taxes is \$34.5 million.

The Withholding Compliance Program does not have a process in place to identify employers that fail to comply with lock-in letters. Reports currently in use and being used as well as those being developed to monitor Program effectiveness do not provide data on employer compliance with lock-in letters.

Taxpayers are generally not penalized for making false statements that result in the underwithholding of taxes.

Under current law and regulations, the IRS may assess a \$500 penalty for furnishing a false statement on Form W-4 if: (1) the statement results in less income tax withheld than what would have been withheld if the form had been correctly completed, and (2) there was no reasonable basis for the statement.

In May 2006, even though the IRS's authority to assess the \$500 penalty had not changed, the *Internal Revenue Manual* was revised to state that the Form W-4 penalty will be assessed by the Withholding Compliance Program only on referrals from other IRS functions or special projects. TIGTA asserts that this policy is improper because it could result in inconsistent treatment of similarly situated taxpayers solely on the basis of whether their cases were referred from another IRS function. Further, it appears that IRS employees in other functions are not submitting Forms W-4 with their referrals. As a result, in fiscal year 2006 only 29 Form W-4 penalties were assessed, and in fiscal year 2007 none were assessed.

TIGTA estimates that if the IRS removed its current limitations and assessed penalties on all underwithheld taxpayers who were issued lock-in letters, penalties totaling approximately \$127 million could have been assessed against these taxpayers in fiscal years 2006 and 2007.

Changes are needed to improve effectiveness of processing referral cases.

The *Internal Revenue Manual* advises all IRS employees working compliance cases to consider using lock-in letters to correct taxpayers' withholding as a means of ensuring future compliance. However, IRS employees outside of the Withholding Compliance Program do not have access to the systems used to issue lock-in letters. Instead, they are required to submit a referral.

Currently, the Withholding Compliance Program uses three separate information systems for case processing. To maintain the integrity of the information being input into these systems, the Withholding Compliance Program controls all case processing and issuance of lock-in letters.

Recommendations and responses

- Develop a process to identify those employers that do not adequately withhold taxes from their employees after receiving a lock-in letter. *Note:* The IRS said it would develop an annual report to identify employees who continue to work for the same employer after a lock-in letter has been issued yet have no significant change in their withholding patterns.
- Develop employer examination criteria for referring

those employers that did not follow lock-in letter instructions. *Note:* The IRS said it would provide pertinent employer and worker information for use in the Service-Wide Employment Tax Research System, currently under development.

- Develop and deliver training to appropriate IRS employees on the criteria for the current referral process. *Note:* The IRS said it would develop a training module outlining the Withholding Compliance Program referral criteria for use across divisions.

- Develop criteria to expand use of the Form W-4 penalty beyond the current limitation of referrals and special projects. *Note:* The IRS said it would evaluate the current guidelines and make recommendations on expanding them.

- Create a single data entry point for processing Withholding Compliance Program cases, and provide lock-in letter issuance authority to other IRS functions. *Note:* The IRS said it planned to develop a web-based format that would allow a single point of entry that, in turn, would allow communication between compliance systems. ■

Ninth Circuit Court of Appeals Upholds Arizona Immigration Law

The Legal Arizona Workers Act (LAWA; see **PAYROLL CURRENTLY, Issue No. 15, Vol. 15**) requires Arizona employers to verify the employment eligibility of newly hired employees through the federal Basic Pilot Program (now E-Verify). Under LAWA, an Arizona employer that intentionally or knowingly employs an unauthorized alien faces suspension of its business licenses for a first violation and permanent revocation of all business licenses for a second violation.

The Ninth Circuit Court of Appeals has ruled that LAWA is not pre-empted by the Immigration Reform and Control Act of 1986 (IRCA) or the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA), nor does it violate the due process rights of employers [*Chicanos Por La Causa, Inc. v. Napolitano*, No. 07-17272, 2008 U.S. App. LEXIS 19723 (9th CA, 9-17-08)].

IRCA. IRCA expressly preempts any state or local laws that impose civil or criminal sanctions “other than through licensing and similar laws” (8 USC §1324a(h)). The court rejected the argument that the licenses contemplated by §1324a(h) are limited to licenses for specific professions such as law or medicine. LAWA’s definition of licenses includes permits, certificates, and approvals issued for the purpose of operating a business in the state, which are matters with which states have traditionally been concerned. LAWA does not define who is eligible to work, but enforces federal standards in federal immigration law. LAWA falls within the §1324a(h) exception because it does nothing beyond imposing conditions on state licenses to do business and is thus not preempted by IRCA.

IIRIRA. E-Verify was developed in response to a mandate imposed by IIRIRA. Congress made the use of E-Verify voluntary at the national level, but the court said that does not mean it intended to prevent states from mandating its use. Moreover, Congress has implicitly encouraged the use of E-Verify because it has extended the program to all 50 states, and LAWA’s requirement that employers participate in E-Verify furthers this purpose and does not cause a conflict with federal law that requires preemption.

Due process rights. Under the Due Process Clause of the U.S. Constitution, a person cannot be deprived of a property interest without notice and an opportunity for a hearing. Because an Arizona business license is a property interest, employers must be given an opportunity to be heard before their business licenses are suspended or revoked under LAWA. The court explained that LAWA does not violate the Due Process Clause because although the statute bases an employee’s authorization to work on a federal determination, it states that the federal determination of the employee’s status is a rebuttable presumption. LAWA therefore implicitly provides an employer with the opportunity to present rebuttal evidence during the state court proceeding that is held to determine whether a LAWA violation has been committed.

Note: In upholding LAWA, the Ninth Circuit noted that the law has so far not been enforced and cautioned that its ruling in this case will have no precedential effect “if and when the statute is enforced, and the factual background is developed.” ■

Daylight Saving Time Ends November 2

Daylight Saving Time (DST) ends Sunday, November 2 at 2 a.m., when clocks are set back one hour throughout most of the U.S. Shift workers on duty at that time will work one hour more than usual. These employees must be paid for the extra hour, and the extra hour must be counted for purposes of calculating the regular rate of pay and overtime (see *The Payroll Source*®, p. 2-51 for further information).

DST is not observed in the states of Arizona (other than inside the Navajo nation) and Hawaii, and in the territories of American Samoa, Guam, Puerto Rico, and the Virgin Islands.

Note: The Energy Policy Act of 2005 (Pub. L. No. 109-58) included a provision extending DST from the second Sunday of March to the first Sunday of November, effective March 1, 2007. ■

Salary Reduction Contributions to Pay for Medical Expenses After Retirement Are Excludable From Income

In a private letter ruling, the IRS has ruled that mandatory salary reduction contributions made to a trust that are used exclusively to pay for accident or health coverage for retired employees, their spouses and dependents (as defined in IRC §152), are excludable from gross income under IRC §106 [LTR 200837002, 6-5-08; www.irs.gov/pub/irs-wd/0837002.pdf].

The trust

A union established a trust as a means of funding retiree

health benefits for its members. The trust is designed to allow union members to pre-fund retiree health coverage while they are employed, by mandatory contributions made through salary reduction.

The trust will provide health benefits to retired employees, their spouses, dependents (as defined in IRC §152), and nondependent domestic partners. To the extent coverage is provided to nondependent domestic partners, the value of

coverage for the domestic partner will be currently included in an employee's gross income.

Once approved, all bargaining unit members are subject to the terms of the collective bargaining agreement. No employee may elect whether to participate, or choose the contribution amount. There is no individual employee election with respect to any part of the program.

If the bargaining unit votes to participate in the program, then mandatory contributions are negotiated into the collective bargaining agreement for the entire bargaining unit. Mandatory salary reduction contributions are automatically deducted from an employee's wages and placed in an employee account in the trust. Employees can only receive funds from the account after retirement, and only for health insurance premiums or the reimbursement of medical expenses. Contributions cannot be rebated or refunded to employees.

Analysis

Under IRC §106 an employee's gross income does not include employer-provided coverage under an accident or health plan. In addition, coverage provided under an accident or health plan to former employees and their spouses and dependents is excludable from gross income.

The regulations (26 C.F.R. §1.106-1(a)) provide that an employee's gross income does not include contributions the employer makes to an accident or health plan to compensate the employee for personal injuries or sickness incurred by the employee or the employee's spouse or dependents (as defined in IRC §152).

The employer may contribute to an accident or health plan either by paying the premium on an insurance policy covering its employees or by contributing to a separate trust or fund that provides accident and health benefits directly or through insurance to those employees. ■

Treasury, SBA Launch HSA Website

The Treasury Department and the Small Business Administration (SBA) have announced a new website – www.sba.gov/hsa/ – that provides small businesses with information on how Health Savings Accounts (HSAs) can help meet their employees' health care needs.

While many employees have access to health coverage through their employers, many employees work for small companies that are unable to sponsor health insurance plans. Many of these employees can benefit from the affordability and flexibility of HSAs and HSA-eligible health plans.

The new website presents the advantages of HSAs, provides comparisons to other health coverage options, offers answers to frequently asked questions, and includes other materials and resources to help employers and individuals determine whether and how to enroll in HSA-eligible coverage and how to save for health care costs through an HSA.

In addition, a new "Health Savings Account Fact Sheet" is available at www.sba.gov/idc/groups/public/documents/sba_program_office/hsa_factsheet.pdf. ■

Gymboree Store Manager Was FLSA-Exempt Executive

The manager of a Gymboree retail store in Palm Beach Gardens, Florida, was not entitled to overtime wages under the Fair Labor Standards Act (FLSA) because she was an exempt executive employee, a U.S. District Court has ruled [*Langley v. Gymboree Operations, Inc.*, 530 F.Supp. 2d 1297 (SD Fla., 1-8-08)].

Neda Langley sued Gymboree for unpaid overtime, saying that despite her position as "store manager," her primary function was to make sales to customers like the nonexempt assistant store managers and sales associates at the store. The question for the court was whether her primary duty was management.

Analysis

Under FLSA regulations (29 C.F.R. §541.700), employees who spend more than 50% of their time performing exempt work will generally satisfy the primary duty requirement for exemption, but time alone is not the sole determinant. Employees who spend less than half of their time performing exempt work can still satisfy the primary duty requirement of management if other factors support that conclusion, such as:

- the amount of time spent performing exempt work;
- the relative importance of managerial duties compared to other duties;
- the relationship between the employee's salary and the wages paid to employees who perform relevant nonexempt work; and
- the employee's relative freedom from supervision.

Time spent performing exempt work. Langley spent more than half of her time on the sales floor, but it is common for store managers to perform managerial tasks at the same

time as nonexempt tasks. Here, Langley had sales assistants working on the floor and she was responsible for exercising sales leadership, which was a managerial task.

Relative importance of managerial duties. As store manager, Langley performed managerial duties that included: interviewing, selecting, and training employees; setting pay rates and work schedules; evaluating employee productivity; disciplining employees; and responsibility for employee safety. All of these functions were critical to the success of the store because Gymboree could not have operated the store unless Langley performed them.

Relative compensation. Langley was compensated on a salary basis at an annual rate of between \$40,000 and \$45,000, and was the only person at her store classified as a salaried overtime-exempt employee. On the other hand, the highest paid full-time assistant manager was paid \$15 an hour, the highest paid sales associate earned \$10 an hour, and most employees made \$7 an hour.

Freedom from supervision. Langley reported to a district manager who was not based at the store, was responsible for 18 stores in south Florida, and did not regularly visit the stores. Occasionally, Langley had no contact with her district manager other than the weekly conference calls with all of the other store managers in her district. There was a gap of several months during which Langley had no district manager above her. And regional managers, to whom district managers reported, only visited Langley's store twice a year. Langley was clearly in charge of the day-to-day operations of her store and enjoyed sufficient freedom from supervision to qualify for exemption. ■

Affirmed: Medical Residents Can Qualify for Student FICA Exception

The Federal Insurance Contributions Act (FICA), which provides that FICA (social security and Medicare) 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 if such service is performed by a student who is enrolled and regularly attending classes at that school, college, or university (26 USC §3121(b)(10)).

The Seventh Circuit Court of Appeals has affirmed that the determination of whether medical residents at the University of Chicago Hospitals can qualify for the student FICA exception must be made on a case-by-case basis (see [PAYROLL](#)

[CURRENTLY](#), Issue No. 22, Vol. 14). The court explained that §3121(b)(10) does not categorically exclude medical residents from eligibility. Accordingly, a case-by-case analysis of eligibility must be made – focusing on the character of the employing organization as a school, college, or university, and its relationship with the employee claiming student status [*University of Chicago Hospitals v. U.S.*, No. 07-1838, 2008 U.S. App. LEXIS 20075 (7th CA, 9-23-08)].

Note: In regulations and other guidance, the IRS has taken the position that medical residents do not qualify for the student FICA exception (see [PAYROLL CURRENTLY](#), Issue No. 1, Vol. 13). ■

Employee Who Made Verbal Complaints Was Not Protected by FLSA Anti-Retaliation Provision

In early 2006, Kevin Kasten received a disciplinary warning from his employer for not using the company’s time clock. After his fourth violation of the company policy requiring employees to punch in and out, he was fired. Kasten then sued the company for retaliation in violation of the Fair Labor Standards Act (FLSA).

Note: Under the FLSA’s anti-retaliation provision (29 USC §215(a)(3)), it is unlawful for an employer “to discharge ... any employee because such employee has filed a complaint or caused to be instituted any proceeding under or related to [the FLSA].”

Here, the court said that the FLSA’s anti-retaliation clause protects an employee “filing” a complaint. Some courts have interpreted this clause to protect any activity by a worker that constitutes assertion of an FLSA right, including oral complaints (see [PAYROLL CURRENTLY](#), Issue No. 6, Vol. 13).

Other courts have interpreted the clause to require lodging a formal complaint with a labor agency or court (see [PAYROLL CURRENTLY](#), Issue No. 10, Vol. 16).

Here, the court took a “middle-of-the-road approach,” ruling that the anti-retaliation clause protects informal complaints, but those complaints must be in writing and “filed” (delivered to “someone who can put it in its proper place”). Kasten complained verbally on several occasions that he thought the location of the time clock was illegal because it meant that employees were not getting paid for all the time they spent donning and doffing gear, but he never put his complaints in writing. His oral complaints were not enough to trigger the anti-retaliation provision and were, at best, abstract expressions of discontent, said the court [*Kasten v. Saint-Gobain Performance Plastics Corp.*, No. 07-cv-686-bbc 1, 2008 U.S. Dist. LEXIS 47686 (WD Wis., 6-19-08)]. ■

Time Spent Donning and Doffing Police Uniform Was Not Compensable

The city of Mesa, Arizona, required its officers to be in uniform at the start of a shift, but did not have a policy about where officers should put on their uniforms and protective gear. Most chose to change into and out of their uniforms and gear away from the police station. Motorcycle officers donned and doffed their uniforms at home because their shifts began when they left their homes. The officers sued the city, saying that its failure to compensate them for “donning and doffing” their police uniforms violated the Fair Labor Standards Act (FLSA).

WHAT THE LAW SAYS – Activities that are “preliminary or postliminary” to an employee’s principal work activity are not compensable work time unless a contract or custom of the employer makes them compensable. A principal activity includes all activities that are “integral and indispensable” to the principal activity. This means that time spent by an employee to get ready for work or to get ready to leave work is not work time unless the activities engaged in are essential to the employee’s principal work activity. If an employee must change clothes (“donning and doffing”) while at work at the beginning and end of a shift, the time spent changing clothes is worktime if changing clothes is integral and indispensable to the

employee’s principal activity (see *The Payroll Source*®, pp. 2-59 and 2-60).

Ruling

Here, the court said the question was whether the nature of the police officers’ work required the donning and doffing to be done at the station or reporting place, not whether the uniforms or gear were necessary or integral to the performance of their duties.

Neither the city nor the police department required the officers to don and doff their uniforms and gear at the police station or reporting location. Only a few officers changed at work, and the remaining officers either changed at home or split the process between home and the station. Because the officers had the option and ability to don and doff their uniforms and gear at home, the court said the donning and doffing was noncompensable preliminary and postliminary activity [*Bamonte v. City of Mesa*, No. CV 06-1860-PHX-NVW, 2008 U.S. Dist. LEXIS 31121 (D Ariz., 4-14-08)].

Note: Courts disagree on this issue. This decision is in accord with *Martin v. City of Richmond* (see [PAYROLL CURRENTLY](#), Issue No. 21, Vol. 15). It conflicts with *Lemmon v. City of San Leandro* (see [PAYROLL CURRENTLY](#), Issue No. 5, Vol. 16). ■



STATE AND LOCAL NEWS

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California

Commuter benefits mandated for San Francisco employers. Effective 1-23-09, employers (except for government entities) with an average of 20 or more workers a week must provide commuter benefits to all covered employees who work an average of at least 10 hours a week in the city of San Francisco. At least one of the following benefit programs must be offered: (1) a pre-tax election program allowing employees to elect to exclude employee commuting costs from taxable wages; (2) an employer-paid benefit program; or (3) an employer-provided transit program. An employer that fails to offer a benefit program as required is guilty of an infraction and subject to fines [City and County of San Francisco Ordinance No. 199-08, 8-22-08].

Colorado

PEO certification required. By 10-6-08, all employee leasing companies, also known as professional employer organizations (PEOs), must submit Form UITL-70, *Application for Certification as an Employee-Leasing Company*, to conduct business in Colorado. The initial certification is valid until 6-30-10. An annual certification renewal is required on or before June 30 of each year thereafter. Beginning with all wages paid on or after 1-1-09, PEOs must report and pay unemployment insurance taxes using their own account numbers, not the account numbers of worksite employers or clients [Department of Labor and Employment, *UI Quarterly News*, 3rd Quarter 2008].

New York

Mandatory overtime for nurses limited. Effective 7-1-09, health care employers cannot require nurses to work more than their regularly scheduled work hours. "Regularly scheduled work hours" include: (1) hours a nurse has agreed to work and is normally scheduled to work; (2) pre-scheduled on-call time; and (3) time spent communicating shift reports on patient care to ensure patient safety. A nurse may be required to work beyond his or her regularly scheduled work hours if there is a natural disaster; a federal, state, or county declaration of emergency; a health care employer determined emergency; or if a nurse is actively engaged in an ongoing medical procedure. A nurse may voluntarily agree to work overtime hours [S.B. 8637, L. 2008].

Oregon

Minimum wage increases. Effective 1-1-09, the minimum wage will increase to \$8.40 an hour from \$7.95 an hour (this updates *The Payroll Source*®, p. 2-66). State law requires the minimum wage to be adjusted for inflation every year [Bureau of Labor and Industries, Press Release, 9-16-08].

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