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## IRS Releases New Form 941-X for Correcting Employment Tax Errors

The IRS has released new Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, together with *Instructions for Form 941-X*. The form and instructions are available on the APA website at [www.americanpayroll.org/members/Forms-Pubs/#tax](http://www.americanpayroll.org/members/Forms-Pubs/#tax).

### New form

Form 941-X replaces Form 941c, *Supporting Statement to Correct Information*, which should not be used any more. Use Form 941-X to make corrections to previously filed Forms 941. **Do not** attach Form 941-X to Form 941; file Form 941-X separately.

Form 941-X also replaces Form 843, *Claim for Refund or Request for Abatement*, for employers requesting a refund or abatement of overreported employment taxes. However, continue to use Form 843 when requesting a refund or abatement of assessed interest or penalties.

### New process

After December 31, 2008, when you discover an error on a previously filed Form 941, you **must**:

- correct that error using Form 941-X,
- file a separate Form 941-X for each Form 941 that you are correcting, and

- file Form 941-X separately. **Do not** file Form 941-X with Form 941.

Beginning with the first quarter of 2009, Form 941 will no longer provide adjustment lines (formerly lines 7d through 7g) for correcting prior quarter errors. However, continue to report current quarter adjustments for fractions of cents, third-party sick pay, tips, and group-term life insurance on Form 941 using lines 7a through 7c.

Report the correction of underreported and overreported amounts for the same tax period on a single Form 941-X, unless you are requesting a refund or abatement. If you are requesting a refund and are correcting both underreported and overreported amounts, file one Form 941-X correcting the underreported amounts only and a second Form 941-X correcting the overreported amounts.

Follow the chart on the back of Form 941-X for help in choosing whether to use the adjustment process or the claim process.

**Caution:** Do not use Form 941-X to correct Forms CT-1, 943, 944, 944-SS, or 945. Instead, use the "X" form that corresponds to the return you are correcting (Form CT-1 X, 943-X, 944-X, or 945-X). ■

## Payroll Solutions

**Q.** I know that under the Consumer Credit Protection Act (CCPA), an employer may not discharge an employee whose earnings are subject to a garnishment. Without violating the CCPA, could we instead suspend, demote, or transfer employees when we receive a garnishment?

**A.** Probably not. The CCPA prohibits an employer from discharging an employee whose earnings are subject to garnishment for any “one indebtedness.” This prohibition applies to all types of garnishments, including tax levies, bankruptcy orders, and child support withholding orders.

According to the U.S. Department of Labor (DOL) Field Operations Handbook (§16c03), “one indebtedness” means a single debt, regardless of the number of levies made or the number of separate garnishment proceedings instituted in connection with the indebtedness. If a garnishment is levied after a judgment, the DOL regards the judgment itself as the “debt.” This debt may represent one or more claims of a single creditor or the claims of several creditors who joined in the proceeding.

Employee suspensions can also violate the CCPA. Although the CCPA protects employees with a garnishment for a single indebtedness from “discharge,” the Field Operations Handbook (§16c04) advises that this includes any adverse action that interrupts employment to the degree that a prudent employee would look for another job. A long suspension is considered the equivalent of a termination of employment, and therefore a “discharge.” For example, if an employer disciplines an employee via a series of gradually increased suspensions of several days’ duration following subsequent garnishments on the same indebtedness, it could result in a violation of the CCPA. Even where a suspension is for a short duration (e.g., 10 days), the circumstances may indicate that a discharge in violation of the CCPA has occurred.

Finally, §16c04 says that a demotion and/or transfer based wholly or in part on a single garnishment is a constructive discharge in violation of the CCPA. “A reasonable interpretation of the effect of transferring a person to a position paying less money is that of a discharge.”

See *The Payroll Source*® p. 9-42 for more information about the CCPA and protection for employees who receive garnishments.

## Employer Groups Sue to Stop Mandatory E-Verify for Federal Contractors

The Department of Homeland Security (DHS) recently issued final regulations (see **PAYROLL CURRENTLY, Issue No. 24, Vol. 16**) requiring government contractors and subcontractors to use the E-Verify system to verify that new hires and current employees working on federal contracts are eligible to work in the U.S. The regulations are effective January 15, 2009.

On December 23, the U.S. Chamber of Commerce filed a lawsuit seeking (1) a declaration that the regulations, and the executive order they implement, are illegal and void, and (2) an injunction barring their enforcement [*Chamber of Commerce USA v. Chertoff*, No. 8:08-cv-03444-AW (D Md., complaint filed 12-23-08)].

Joining in the lawsuit are Associated Builders and Contractors, Inc., the Society for Human Resource Management, the American Council on International Personnel, and the HR Policy Association.

The primary basis for the complaint is language in the Illegal Immigration Reform and Immigrant Responsibility

Act of 1996 (IIRIRA) authorizing various “pilot programs of employment eligibility confirmation.” The complaint alleges that the executive order and the final regulations “violate the express statutory prohibition against ‘requir[ing] any person or other entity to participate in a pilot program’ such as E-Verify.”

The suit also alleges that participation in E-Verify is limited by the statute to employment verification of new hires in connection with the I-9 process, and that DHS may not require verification of existing employees.

Finally, the complaint alleges that DHS has failed to meet its obligations under the Regulatory Flexibility Act by failing to evaluate the significant costs to employers of implementing the regulations and less harmful alternatives to its actions before taking them. For example, the complaint cites the DHS estimate that compliance costs for fiscal 2009 will total \$188,138,945 (in the proposed regulations, the figure was only \$61,630,740, even though the proposed regulations were tougher). ■

## IRS Releases 2009 Pub 15-A, Employer’s Supplemental Tax Guide

The 2009 supplement to Circular E, *Employer’s Supplemental Tax Guide* (Pub. 15-A), has been released by the IRS. Pub. 15-A contains specialized and detailed employment tax information. The publication is available on the APA website at [www.americanpayroll.org/members/Forms-Pubs/#annual](http://www.americanpayroll.org/members/Forms-Pubs/#annual). Items to note include:

- **New employment tax adjustment process in 2009.** If you discover an error on a previously filed employment tax return after December 31, 2008, make the correction by filing the form that corresponds to the form being corrected. For example, on March 1, 2009, you discover an error on your 2007 fourth quarter Form 941, *Employer’s Quarterly Federal Tax Return*. You would file Form 941-X, *Adjusted Employer’s*

*Quarterly Federal Tax Return or Claim for Refund*, to correct the error. Do **not** use Form 941c, *Supporting Statement to Correct Information*.

- **Furnishing Forms W-2 to employees electronically.**

Employers may set up a system to furnish Forms W-2, *Wage and Tax Statement*, electronically to employees who choose to receive them in that format. Note that electronic Forms W-2 must be furnished by the due date of the paper forms.

Each employee participating must consent (or receive confirmation of any consent made using a paper document) electronically, and must be notified of all hardware and software requirements to receive the forms. An employer may not send a Form W-2 electronically to any employee who does

not consent or who has revoked consent previously provided (see *The Payroll Source*®, pp. 8-58 to 8-60 for further details).

- **Electronic submission of Forms W-4 and W-5.** An employer may set up a system to electronically receive any or all of the following forms (and their Spanish versions, if available) from an employee or payee: Form W-4 (*Employee's Withholding Allowance Certificate*), Form W-4P (*Withholding*

*Certificate for Pension or Annuity Payments*), Form W-4S (*Request for Federal Income Tax Withholding From Sick Pay*), Form W-4V (*Voluntary Withholding Request*), and Form W-5 (*Earned Income Credit Advance Payment Certificate*). If you establish an electronic system to receive any of these forms, you do not need to process that form in a paper version (see *The Payroll Source*®, pp. 6-16 and 6-17 for further details). ■

## IRS Issues Proposed Regulations on Withholding, Information Reporting on Certain Payments by Government Entities

The IRS has issued proposed regulations on withholding under IRC §3402(t) [73 F.R. 74082, 12-5-08; <http://edocket.access.gpo.gov/2008/pdf/E8-28789.pdf>]. The proposed regulations reflect changes in the law made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA; Pub. L. No. 109-222; see *PAYROLL CURRENTLY*, Issue No. 12, Vol. 14).

For payments made after December 31, 2010, TIPRA generally requires information reporting and withholding at the rate of 3% on payments to persons providing property or services to a government entity with \$100 million or more of annual expenditures that are subject to its provisions.

### Payments subject to §3402(t) withholding: payment threshold amount

Under the proposed rules, the withholding requirements of §3402(t) will not apply to any payment that is less than the payment threshold amount, which is \$10,000. This threshold corresponds to a minimum withholding of \$300.

Under the proposed rules, multiple payments made by a government entity to any person generally would not be aggregated in determining whether the payment threshold amount has been met. However, the proposed regulations provide an anti-abuse rule to ensure that the payment threshold is not manipulated to avoid the required withholding.

**Dividing payments due: anti-abuse rule.** If a government entity divides a payment into two or more separate payments primarily to avoid the payment threshold for one or more payments, the separate payments would be treated as one payment made on the date that the first payment was made for purposes of this rule. For example, if a government entity is scheduled to make a contractual payment to a person for landscaping services of \$15,000 on July 2, 2011, but divides the payment into payments of \$7,000 and \$8,000 made on July 1, 2011, and July 2, 2011, respectively, the government entity would be treated as having made a single payment of \$15,000 on July 1, 2011.

**Aggregating payments due.** If a government entity makes a single payment of \$10,000 or more to any person for more than one property or service furnished by that person, the government entity would be required to withhold on the payment. For example, if a person bills a government entity \$5,000 each day for seven days for services provided each day, but the government entity makes one payment of \$35,000 in satisfaction of these bills, the payment threshold is applied to the \$35,000 payment.

**Prime contractors and subcontractors.** Under the proposed rules, if a government entity or its payment administrator makes a payment to a person that is subject to withholding under §3402(t), no subsequent transfer of cash or property by that person to another person is treated as a payment for §3402(t) purposes. Thus, if the government entity enters into a contract with a prime contractor for property and

services, and that prime contractor separately contracts with subcontractors for delivery of certain property and services, then withholding under §3402(t) applies only to payments by the government entity or its payment administrator to the prime contractor, and does not apply to successive payments by the prime contractor to its subcontractors.

**Payment administrators.** Transfers of funds from a government entity to a payment administrator to be used by the payment administrator, on the government entity's behalf, to pay persons for providing property or services are not payments subject to withholding under §3402(t). However, if the government entity pays the payment administrator a fee for its services, the government entity would treat the fee as a payment subject to withholding. Note that the government entity is liable for the withholding required and responsible for all related reporting.

### Credit card payments

Under the proposed regulations, when a government entity or its payment administrator uses a credit card or payment card to pay a person for providing property or services, payment occurs at the point of sale when the government credit card or payment card is tendered and not when the government entity pays the credit card company.

### Partnerships and S corporations

With respect to payments *from* a partnership or S corporation (passthrough entities), the proposed regulations provide that such payments *are not* generally subject to withholding under §3402(t) unless 80% or more of the passthrough entity is owned by government entities that are required to withhold under that section.

With respect to payments *to* a passthrough entity, the proposed regulations provide that such payments *are* generally subject to withholding under §3402(t) unless 80% or more of the passthrough entity is owned by government entities required to withhold under that section.

### Utility payments

The proposed regulations clarify that utility payments are subject to withholding under §3402(t) on the same basis as payments for other property and services.

### Exceptions: payments not subject to withholding under §3402(t)

The TIPRA provision does not apply to payments of wages or to any other payment with respect to which mandatory or voluntary withholding applies under current law. The proposed regulations would provide clarifying guidance.

**Backup withholding.** A payment that is subject to 28% backup withholding is not excepted from the requirement of 3% withholding under §3402(t) unless backup withholding is actually being deducted from the payment. Thus, if backup withholding is required with respect to a payment made by a government entity and the government entity performs backup

withholding on the payment, §3402(t) does not apply.

**Tax treaty situations.** Under the proposed regulations, payments made to nonresident aliens or foreign individuals that are exempt from U.S. taxation pursuant to a treaty would be exempt from withholding under §3402(t), because such payments are subject to withholding absent application of the treaty. Imposing a new withholding requirement on nonresident aliens and foreign corporations that owe no U.S. tax would serve no purpose.

**Nonresident alien individuals and foreign corporations.** In general, in the case of a nonresident alien individual or a foreign corporation, gross income for U.S. income tax purposes consists of (1) gross income derived from sources within the U.S.; and (2) gross income derived from sources outside the U.S., but only if it is effectively connected with a trade or business within the U.S. Therefore, if a foreign person provides services or sells inventory property in a foreign country, it will have no U.S. income tax liability with respect to the income earned from providing the services or selling the property – even to a U.S. government entity – provided that the income is not effectively connected with the conduct of a trade or business within the U.S.

The proposed regulations exclude such payments made to foreign persons from the 3% withholding under §3402(t). *Note:* Procedures to be followed by government entities and foreign persons for purposes of claiming this exception from §3402(t) withholding will be issued at a later date.

**Real property.** The proposed regulations provide that payments for real property include payments for leasing real property and leasehold improvements. However, the proposed regulations adopt the position that payments for the construction of buildings or public works are not payments for real property.

**Total payments under \$100 million.** The proposed regulations provide a simple rule for determining before each year starts whether the exception for certain smaller government entities that make less than \$100 million of payments for property and services annually applies to a given political subdivision or instrumentality. The determination would be based on the payments made during the accounting year of the political subdivision or instrumentality ending with or within the second preceding calendar year.

For example, to determine whether the political subdivision or instrumentality is subject to withholding with respect to payments made in 2011, the proposed regulations would look to whether payments made by the political subdivision or instrumentality for its accounting year ending with or within the calendar year 2009 equaled or exceeded \$100 million.

The proposed regulations would require that all payments for property and services made during the accounting year be considered, except those payments qualifying for an exception under the proposed regulations. For this purpose, payments that are less than the \$10,000 payment threshold count toward the \$100 million test.

**Payments to government entities.** Section 3402(t) withholding does not apply to payments to government entities. The proposed regulations explain that the determination of whether an entity is a government entity such that payments it receives are exempt parallels the determination of whether the entity is a government entity required to withhold on payments it makes.

Thus, if a government entity is required to withhold under

§3402(t), payments to that government entity are not subject to withholding under §3402(t). The proposed regulations also clarify that, even if no withholding is required on payments from a government entity because it qualifies for the exception for political subdivisions and instrumentalities making total payments of less than \$100 million, payments to that government entity are not subject to withholding.

**Program with a needs or income test.** Section 3402(t) withholding does not apply to payments made through programs for which eligibility is determined by a needs or income test. Under the proposed regulations, a program providing disaster relief to victims of a natural or other disaster is considered to be a program for which eligibility is determined under a needs test.

**Payments to employees not otherwise excludable.** Section 3402(t) withholding does not apply to payments to government employees that are not otherwise excludable under that section with respect to the employees' services as employees. Under the proposed regulations, this exception includes any form of compensation that is paid to the employee or on the employee's behalf.

For example, the proposed regulations exclude employer contributions to employee benefit and deferred compensation plans as well as employee contributions to such plans. This exception applies to any payments by an employer for fringe benefits or deferred compensation to, or for the benefit of, an employee.

The proposed regulations provide that the exclusion from §3402(t) withholding also applies to:

- travel reimbursements paid to an employee under an accountable plan for the employee's travel, lodging, and meal expenses; and
- the employee's payments to third parties that provide travel, lodging, and meals that are reimbursable under such plans.

#### **Deposits and reporting of amounts withheld under §3402(t)**

The proposed regulations provide that payers required to withhold amounts under §3402(t) must file Form 945 reporting the amounts withheld. The amounts withheld under §3402(t) must be deposited and reported in the same manner as other nonwage withheld amounts, such as withholding on gambling winnings and pensions.

Additionally, payers required to withhold amounts under §3402(t) must file information returns and furnish payee statements on Form 1099-MISC reporting such payments and tax withheld. *Note* that exceptions relating to Form 1099 would not apply (e.g., the exception for payments to corporations).

#### **Effective date**

The regulations are proposed to apply to payments made after the later of December 31, 2010, or the date that is six months after the publication of final regulations.

**Transition relief: existing contracts.** The proposed regulations provide that payments made under written binding contracts in effect on the later of December 31, 2010, or the date that is six months after the publication of final regulations are not subject to withholding under §3402(t) unless such contracts are materially modified.

*Note:* The IRS is considering whether contracts that contain a renewal option should be considered new contracts as of the date of renewal. The final regulations may provide that a contract that is renewable as of a certain date is treated as a

new contract on the first date it is renewed. Comments are requested on how option terms in contracts, including, e.g., options to renew, should affect the transition relief for payments under written binding contracts.

**Transition rule: penalties and underpayments.** Under a special transition rule, a government entity would not be liable for penalties and interest with respect to liability for withholding imposed by §3402(t), on payments for property or services made before January 1, 2012, if the entity made a good faith effort to comply with the requirements of §3402(t). Note,

however, that this transition rule would not provide relief from liability for the amount of tax required to be withheld under §3402(t).

#### Comments

Comments on the proposed regulations must be received by March 5, 2009. Send written comments to: CC:PA:LPD:PR, Room 5205, 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-158747-06. ■

## IRS Reissues 2009 Pub 15-B With Correction

The IRS has posted a note on its website [[www.irs.gov/formspubs/article/0,,id=109875,00.html](http://www.irs.gov/formspubs/article/0,,id=109875,00.html) (12-23-08)] advising taxpayers that the 2009 Publication 15-B, *Employer's Tax Guide to Fringe Benefits*, has been reissued. Anyone who downloaded the publication before December 18 is alerted that it has been modified. On page 19 under "Qualified Transportation Benefits," the first two sentences in the third paragraph have been

changed to read as follows: "Generally, you can exclude qualified transportation fringe benefits from an employee's wages even if you provide them in place of pay. However, qualified bicycle commuting reimbursements do not qualify for this exclusion."

The corrected version of Publication 15-B is available on the APA website at [www.americanpayroll.org/members/Forms-Pubs/#annual](http://www.americanpayroll.org/members/Forms-Pubs/#annual). ■

## IRS Issues Regulations Modifying Smallest Employers' Annual Federal Tax Program

The IRS has issued temporary [73 F.R. 79354, 12-29-08; <http://edocket.access.gpo.gov/2008/pdf/E8-30582.pdf>] and proposed [73 F.R. 79423, 12-29-08; <http://edocket.access.gpo.gov/2008/pdf/E8-30592.pdf>] regulations modifying the rules relating to the Employer's Annual Federal Tax Program (the Form 944 Program), applicable to taxable years beginning January 1, 2009. *Note:* Previously issued regulations established the program for taxable years beginning January 1, 2006 (see **PAYROLL CURRENTLY**, Issue No. 2, Vol. 14).

#### Program is being made voluntary

For taxable years beginning January 1, 2009, employers that estimate that their annual employment tax liability will be \$1,000 or less can contact the IRS to express their desire to file Form 944 instead of Forms 941 for a taxable year. Only upon such a request will the IRS send a notification letter to qualified employers confirming that they may file Form 944 for that taxable year.

Once employers receive this notice, they must file Form 944 and cannot file Forms 941 instead until they contact the IRS to change their filing requirement to Form 941, and receive confirmation that their filing requirement has been changed.

*Note:* In conjunction with the regulations, the IRS has issued guidance on how employers can contact the IRS to participate in the Form 944 Program in tax year 2009 and how they can opt out if they later decide that they want to file Forms 941 instead of Form 944 [Rev. Proc. 2009-13, released 12-29-08; [www.irs.gov/pub/irs-drop/rp-09-13.pdf](http://www.irs.gov/pub/irs-drop/rp-09-13.pdf)].

Beginning in tax year 2010, employers will be able to opt out for any reason if they follow procedures to be specified in future guidance.

#### Eligibility is unchanged, but ...

Under the regulations, eligibility for the Form 944 Program continues to be limited to employers with an estimated annual employment tax liability of \$1,000. However, the regulations include a provision that allows the IRS to increase the eligibility threshold through other guidance.

#### Tax deposit lookback period clarifications

The regulations clarify that the lookback period for determining whether an employer is a monthly or semiweekly

depositor is the second preceding calendar year for employers that filed Form 944 for either of the two previous calendar years, not just the immediately preceding calendar year. This clarification was needed because an employer would not have filed the quarterly returns needed to use the "12-month period ending June 30" if they filed Form 944 in either of the prior years.

For example, if an employer filed Form 944 in 2006 but not in 2007, the lookback period for 2008 would be 2006, because the employer would not have filed quarterly returns for July through December 2006, and it would therefore be impossible to use July 2006-June 2007 as the lookback period.

In addition, the regulations clarify that the amount of tax reported during the lookback period is determined without regard to the employer's filing requirement.

In the preceding example, for instance, if an employer is required to file Forms 941 for 2008 but filed Form 944 for the lookback period (2006), the amount of employment tax liability reported for the lookback period would be the amount of employment tax the employer reported on its Form 944 for 2006 even though the employer will file Forms 941 to report its 2008 liability.

The reverse is also true. The employment tax liability reported for the lookback period (2006) of an employer required to file Form 944 for 2008 would be the sum of the liabilities it reported on its four Forms 941 for 2006.

#### De minimis safe harbor

The regulations incorporate the safe harbor that was included in the 2006 proposed regulations regarding an employer's ability to pay a de minimis amount of employment taxes with its quarterly return rather than having to deposit that amount monthly or semi-weekly. Employers may remit employment taxes with their timely filed quarterly returns and are deemed to have timely deposited those taxes if the amount of the taxes due for the current quarter *or for the prior quarter* is less than \$2,500. This change eases the burden on employers whose payroll tax amounts increase from under \$2,500 to \$2,500 or more from one quarter to the next. ■

## W-H Roundup: Temp Agency Agrees to Pay More Than \$1.8 Million to Misclassified Workers

The U.S. Department of Labor (DOL) has announced that 888 Consulting Group, Inc., a Dedham, Massachusetts temporary employee placement company doing business as TAC Worldwide, has agreed to pay 973 employees across the country a total of \$1,866,943 in back overtime wages to resolve a lawsuit brought by the DOL under the Fair Labor Standards Act (FLSA) [ESA News Release 08-1734-BOS, 12-2-08].

The DOL filed a lawsuit after an investigation by the Wage and Hour Division disclosed that the company had misclassified as exempt from the FLSA's overtime requirements four

employees at its headquarters in Dedham and 969 temporary placement employees across the country. The headquarters employees held positions as payroll systems analysts and accountants, while workers in other parts of the U.S. held temporary positions including: project manager, business or project analyst, technical support, field engineer, business analyst, technical writer, financial analyst, network engineer, systems administrator, electrical engineer, technical manager, sales representative, software tester, help desk representative, network administrator, and telecom engineer. ■

## IRS Issues Guidance Allowing §409A Corrections

The IRS has issued guidance giving taxpayers the ability to correct certain operational failures of a nonqualified deferred compensation plan to comply with IRC §409A. The operational failures discussed must be unintentional and must be corrected in the same taxable year. They include failure to defer, excess deferral, incorrect payment, and incorrect exercise price of an otherwise excluded stock right.

Notice 2008-113 [2008-51 IRB 1305; [www.irs.gov/pub/irs-drop/n-08-113.pdf](http://www.irs.gov/pub/irs-drop/n-08-113.pdf)] provides:

- Methods for correcting certain operational failures during the employee's taxable year in which the failure occurs and, for certain employees also during the subsequent taxable year, to avoid income inclusion under §409A;

- Relief limiting the amount includible in income under §409A for certain operational failures during an employee's taxable year that involve only limited amounts;

- Relief limiting the amount includible in income under §409A for certain operational failures regardless of whether the failure involves only limited amounts, but subject to further required actions to correct the failure; and

- Special transition relief for certain operational failures occurring before January 1, 2008.

### Eligibility

A taxpayer claiming the relief provided in Notice 2008-113 must show that all applicable requirements (as spelled out in the Notice) have been met. In addition, the taxpayer must

take commercially reasonable steps to avoid a recurrence of the operational failure. If the same or a substantially similar operational failure has occurred previously, the relief is not available for any taxable year of the employee beginning after December 31, 2008, unless the employer or employee shows that: (1) the employer had established practices and procedures reasonably designed to ensure that such an operational failure would not recur and had taken commercially reasonable steps to avoid a recurrence of the operational failure, and that (2) the operational failure occurred despite the employer's diligent efforts.

*Note:* For taxable years beginning on or after January 1, 2009, Notice 2007-100 (see *PAYROLL CURRENTLY*, Issue No. 26, Vol. 15) is obsolete. Taxpayers may rely on this Notice 2008-113 for taxable years beginning before January 1, 2009. For service recipients (employers) and service providers (employees) entitled to relief under this notice, Notice 2006-100 (see *PAYROLL CURRENTLY*, Issue No. 25, Vol. 14), relating to reporting and wage withholding for 2006, and Notice 2007-89 (see *PAYROLL CURRENTLY*, Issue No. 23, Vol. 15), relating to reporting and wage withholding for 2007, are modified with respect to (1) the amount that is required to be included in income by a service provider under §409A, and (2) the amount that is required to be reported by the service recipient as an amount includible in income under §409A on Form W-2 (Box 1 and Box 12, using Code Z) or Form 1099-MISC (Box 7 and Box 15b). ■

## Livestock Company's Salespersons Were Employees

The Porter Livestock Company manufactured and sold nutritional products for swine, and dairy and beef cattle. To sell its products, Porter relied on a sales force it classified as independent contractors. After an audit, the IRS decided that the salespersons were employees and sued to recover more than \$90,000 in unpaid employment taxes. The court considered the following factors and found that the preponderance of the evidence indicated that Porter's salespersons were employees.

**Factors indicating independent contractor status.** Salespersons set their own hours, were not required to inform the company of their whereabouts, set their own work schedules, and had no set territory. The company did not require salespersons to

submit regular or written reports, and the few who submitted written reports did so voluntarily.

**Factors indicating employee status.** Salespersons were reimbursed for business expenses including copying, gas and lodging expenses, and advertising fees. The company provided the vehicles they used to make sales calls and deliveries. Salespersons did not invest in the facilities they used to perform their work for Porter. The company could discharge salespersons at any time, and salespersons could terminate their employment relationship with Porter at any time [*U.S. v. Porter*, No. 4:05-cv-00464-JEG, 2008 U.S. Dist. LEXIS 58858 (SD Iowa, 8-4-08)]. ■

## IRS Releases Guidance on FICA Tax Credit on Employee Tips

In a legal memorandum, the IRS discusses situations arising under IRC §3121(q) where an employer receives a "notice and demand" for additional FICA taxes (employer's share) for tips not reported by employees in a prior year. The Service

concludes that the employer's business tax credit under IRC §45B – for the employer's share of FICA taxes paid on employee tips above the minimum wage – is available in the year of notice and demand under §3121(q), not the year in

which the unreported tips were received by the employee [ILM 200845052, 9-19-08].

#### Scenario

The situation considered by the IRS in its memorandum was as follows: In a prior tax year, an employee receives cash tips that constitute “wages” under IRC §3121(a), but the employee fails to report the tip amounts to his or her employer in the year the tips are received. Then, in the current tax year, the employer receives a notice and demand for the employer share of FICA taxes as provided in §3121(q) with respect to the tip amounts the employee received in the prior year. The employer seeks a current year credit under §45B for the amount of the FICA tax.

#### Analysis

The §45B credit is applied to the taxable year that the

“excess social security tax” amount is paid or incurred, and the definition of “excess social security tax” (§45B(b)(1)) is limited to tips that “are deemed to have been paid by the employer to the employee pursuant to §3121(q).” In light of this definition, the Service said such tax amounts cannot be paid or incurred before the tip amounts are deemed to have been paid under §3121(q), which occurs on the date the “notice and demand” for the employer portion of the FICA tax is made to the employer.

Note that the fact that the unreported tip amounts are deemed to have been paid at the time of notice and demand for purposes of §3121(q) or that the employer’s §45B credit applies in the year of notice and demand, does not change the character of the tip amounts as wages for purposes of §3121(a) when they are actually received by the employee. ■

## On-Call Pay Must Be Attributed to the Week It Is Earned

In a Wage-Hour opinion letter, the U.S. Department of Labor (DOL) advises a city with a biweekly pay period how to correctly compute the regular rate of pay for overtime purposes when employees are on call one week during the pay period [W-H Op. Ltr., FLSA2008-6 (9-22-08)].

Hourly workers at a city’s water treatment plant may be on call one week each month, for which they receive on-call pay of \$2.50 per hour. In the event that an emergency requires an employee on call to return to the plant, the employee is paid wages for actual work performed. The employees’ on-call time is not compensable work time under the Fair Labor Standards Act (FLSA).

The city pays its workers every two weeks and would like to calculate their regular rate of pay by spreading the on-call pay across the two-week pay period. For example, if an employee making \$10 per hour works 40 hours in Workweek 1 of a pay period, works 45 hours in Workweek 2, and earns \$100 in on-call

pay during Workweek 2, the city would calculate the regular rate of pay for purposes of computing the overtime due for Workweek 2 by dividing the \$950 earned for the two weeks by the 85 hours worked. The city’s calculation would produce a regular rate of pay of \$11.18 per hour for Workweek 2 ( $\$400 + \$450 + \$100 \div 85 = \$11.18$ ) that would result in a total payment of \$977.95 to the employee.

The DOL explains that the FLSA uses a single workweek as its standard and does not permit the averaging of hours over two or more workweeks. In addition, on-call pay must be included in an employee’s regular rate of pay. Here, because the specific hours when on-call pay is earned are identifiable, the on-call payment must be attributed to the workweek in which the hours occurred. Applying these rules to the example, the employee’s regular rate of pay for Workweek 2 (which would include the on-call pay) would be \$12.22 per hour ( $\$450 + \$100 \div 45 = \$12.22$ ), resulting in a total payment to the employee of \$980.55. ■

## Substitute Teachers Can Qualify for the FLSA Professional Exemption

In a Wage-Hour opinion letter, the U.S. Department of Labor (DOL) discusses the applicability of the Fair Labor Standards Act (FLSA) professional exemption to substitute teachers [W-H Op. Ltr., FLSA2008-7 (9-26-08)].

In the case considered by the DOL, substitute teachers are not required to have a college degree or teaching certificate. They are only required to obtain a teaching permit from the state professional standards board, which requires substitute teachers to either: (1) complete 65 college semester hours or obtain an associate’s degree from a regionally or nationally accredited institution; or (2) obtain a high school diploma or G.E.D. certificate and complete 24 hours of in-service training, along with 10 hours of classroom observation.

The DOL takes the position that substitute teachers must be evaluated on a case-by-case basis to determine if they qualify for the teacher exemption (29 C.F.R. §541.303). Here, after noting that there is no minimum educational or academic degree requirement for bona fide teaching professionals in educational institutions, the DOL concludes that substitute teachers can qualify for the professional exemption as teachers whether or not they possess an advanced academic degree so long as teaching is their primary duty. *Note:* Substitute teachers whose primary duties are not related to teaching – e.g., performing general administrative or clerical tasks for the school, or manual labor – are not exempt professionals. ■

## Insurance Sales Agents Were Employees

The U.S. Court of Appeals for the Fifth Circuit has affirmed that sales agents working for Cornerstone America, the marketing and sales division of Mid-Western National Life Insurance Co., were employees under the Fair Labor Standards Act (FLSA) and therefore entitled to overtime pay [*Hopkins v. Cornerstone America*, 545 F.3d 338 (5th CA, 10-13-08)].

The Fifth Circuit concluded that the “economic reality” of the relationship between the sales agents and Cornerstone indicated that the agents were employees. Cornerstone controlled the meaningful aspects of the business, such as hiring, firing, assignment, and promotion of sales agents; the fact that the

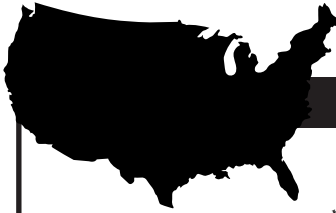
agents had some flexibility in the hours, days, and places they worked was of minor importance. Cornerstone’s investment in offices, marketing, accounting, and insurance products outweighed investments by the sales agents in their own offices.

The opportunity for profit and loss was controlled almost exclusively by Cornerstone, which regulated the opportunities for “overwrite” commissions (the ability of a sales agent to earn commissions based on the sales of subordinate agents) and prohibited sales agents from selling competing insurance products or owning other businesses. In addition, the sales agents needed only a general set of skills common to all effective

managers to run their offices; they did not need any specialized skills. And many of the sales agents had a relationship with Cornerstone for several years that weighed in favor of employee status.

Finally, the fact that the sales agents had signed contracts

agreeing to be, and actually believed themselves to be, independent contractors did not change the economic reality that they were employees. (See *PAYROLL CURRENTLY*, Issue No. 10, Vol. 16, for an earlier decision in this case.) ■



## STATE AND LOCAL NEWS

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### Illinois

**Mandatory participation in Electronic W-2 Transmittal pilot project for PSPs announced.** Effective for 2008 Forms W-2 filed in 2009, payroll service providers (PSPs) that file payroll returns and complete Forms W-2 for employers are required to participate in the Electronic W-2 Transmittal pilot project with the Department of Revenue (DOR). PSPs must file all electronic Form W-2 and Form W-2c information for their clients with the DOR using the federal EFW2 and EFW2c electronic filing formats. Additional specifications for state record layouts are available at [www.iltax.org/ElectronicServices/EFW2SpecsGuide.pdf](http://www.iltax.org/ElectronicServices/EFW2SpecsGuide.pdf). The due date for submitting Forms W-2 electronically is 3-31-09. Generally, employers are not required to file Forms W-2 with the DOR unless requested to do so (see *The Payroll Source*®, p. 8-104) [86 Ill. Adm. Code §100.7300(b)(2); DOR, *Form W-2 Electronic Filing Specifications*, 12-22-08].

### Maine

**Threshold lowered for mandatory electronic filing of returns.** Beginning with the first calendar quarter of 2009, employers, third-party filers, payroll processors, and non-wage payers must file quarterly withholding returns and annual reconciliation returns electronically if they have 50 or more (currently 75 or more) employees/clients/payees that are subject to withholding (see *PAYROLL CURRENTLY*, Issue No. 18, Vol. 16). This threshold will decrease to 10 or more employees/clients/payees, beginning with the second quarter of 2009, and to five or more employees/clients/payees, beginning 1-1-10 [Maine Revenue Services, *2009 Withholding Tables for Individual Income Tax*].

### Missouri

**Withholding tables issued.** Effective for wages paid on or after 1-1-09, the Department of Revenue (DOR) has issued wage-bracket and percentage method withholding tables (available at <http://dor.mo.gov/tax/business/withhold>) [DOR, Pub. DOR-4282, *Employer's Tax Guide*].

### Ohio

**Updated list of school district income tax rates issued.** The Department of Taxation (DOT) has issued a list of 172 school districts that have income tax levies and the current rates as of January 2009. This includes new taxes, rate changes, districts that have changed from using a traditional tax base to an earned income tax base, renewed taxes, and expired taxes. The DOT has also issued the employer letter that explains school district withholding requirements for 2009. Download both documents at [http://tax.ohio.gov/divisions/school\\_district\\_income/index.stm](http://tax.ohio.gov/divisions/school_district_income/index.stm).

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