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## New Stimulus Law Means New Withholding Tables and COBRA Payments Funded by Payroll Taxes

On February 17, 2009, President Barack Obama signed the "American Recovery and Reinvestment Act of 2009" (ARRA; Pub. L. No. 111-5) into law. The centerpiece of this legislation, which is aimed at jump-starting the American economy, is a $400 individual "Making Work Pay" income tax credit ($800 for joint filers) for 2009 and 2010 that will be distributed through reduced withholding from workers' paychecks. This and other provisions of interest to payroll professionals are itemized below.

### Making Work Pay income tax credit

ARRA provides eligible individuals a refundable income tax credit for 2009 and 2010. The credit is the lesser of (1) 6.2% of an individual's earned income or (2) $400 ($800 for married individuals filing jointly) for each year.

The credit is phased out at a rate of 2% of the eligible individual's modified adjusted gross income (AGI) above $75,000 ($150,000 for joint filers). Therefore, individuals with modified AGI over $95,000 ($190,000 for joint filers) are ineligible for the credit. To be eligible for the credit, an individual must provide a valid social security number issued by the SSA, not a taxpayer identification number (TIN or ITIN) issued by the IRS. Nonresident aliens and those who can be claimed as a dependent by another taxpayer are not eligible for the credit.

☞ NEW TABLES WITH EXTRA REDUCED WITHHOLDING — According to the Conference Agreement accompanying the bill, the tax credit will be implemented through revised income tax withholding tables designed to reduce withholding so that the full amount of the credit will be implemented during the remainder of 2009. This means that 12 months of reduced withholding for 2009 will be accomplished in a compressed timeframe beginning with the effective date of the tables.

***Definitions.*** The definition of *earned income* is the same as for the earned income tax credit with two modifications:

- Earned income for these purposes does not include net earnings from self-employment that are not taken into account in computing taxable income;
- Earned income for these purposes includes combat pay excluded from gross income under IRC §112.

*Modified adjusted gross income* is an eligible individual's adjusted gross income increased by any amount excluded from gross income because of the foreign earned income or housing cost exclusion or because of the exclusions for amounts earned in certain U.S. possessions and Puerto Rico.

### COBRA premium subsidies to come from payroll taxes

ARRA provides that, for up to nine months, if an assistance eligible individual pays 35% of the COBRA continuation premium, the group health plan must treat the individual as having paid the full premium required for COBRA continuation coverage, and the individual would be entitled to a subsidy of 65% of the premium. *Note:* If a person other than the individual's employer (e.g., a parent or guardian) pays on the individual's behalf, then the individual is treated as paying 35% of the premium and is entitled to the premium subsidy.

***Assistance eligible individual.*** An assistance eligible individual is any qualified beneficiary who elects COBRA

## Payroll Solutions

**Q.** I have just been hired to work in the payroll department of a company that regularly hires day laborers. These employees are paid for the day they work, but may or may not work a full week. Management says that they should not be paid for overtime because they are only employed by the day. Is this correct?

**A.** No. Under the Fair Labor Standards Act (FLSA), all covered employees must be paid at least 1½ times their "regular rate of pay" for all hours physically worked over 40 in a workweek. In other words, they must receive an overtime premium of one-half their regular rate of pay for all overtime hours worked (see *The Payroll Source®*, p. 2-38). So, if these employees are covered under one of the tests for FLSA coverage (see *The Payroll Source®*, pp. 2-4, 2-5), they must receive overtime pay for hours worked in excess of 40 in a workweek.

FLSA regulations (29 C.F.R. §778.112) explain how to calculate overtime pay for employees paid by the day. If an employee receives no compensation other than the pay for the day, the employee's regular rate is determined by totaling all the sums received at such day rates during the workweek and dividing by the total hours actually worked. The employee is then entitled to extra half-time pay at this rate for all hours worked in excess of 40 in the workweek. The following example illustrates how to compute the pay of an employee paid on a daily basis.

*EXAMPLE:* An employer's workweek runs from Monday to Sunday. An employee is hired to work on a day basis and will receive $100 for the day. The employee works 9 hours on Monday, 11 hours on Thursday, 9 hours on Friday, 12 hours on Saturday, and 10 hours on Sunday.

Total day rate compensation for the workweek: 5 days x $100 = $500
Total hours worked during the workweek: 9 + 11 + 9 + 12 + 10 = 51
Overtime hours: 51 – 40 = 11
Regular rate of pay: $500 ÷ 51 = $9.80 per hour
Overtime premium rate: $9.80 x .5 = $4.90
Overtime pay: $4.90 x 11 hours = $53.90
Total pay due employee: $500 + $53.90 = $553.90

continuation coverage and satisfies two additional requirements. First, the qualifying event must be a loss of group health plan coverage on account of an involuntary termination of the covered employee's employment (other than an involuntary termination for gross misconduct). Second, the qualifying event must occur during the period beginning September 1, 2008, and ending December 31, 2009, and the qualified beneficiary would have to be eligible for COBRA continuation coverage during that period and elect such coverage.

***Termination of eligibility for reduced premiums.*** The assistance eligible individual's eligibility for the subsidy ends with the first month beginning on or after the earlier of:

- the date that is nine months after the first day of the first month for which the subsidy applies,
- the end of the maximum required period of continuation coverage for the qualified beneficiary under the IRC or other state or federal law or regulation, or
- the date the assistance eligible individual becomes eligible for Medicare benefits or health coverage under another group health plan.

Note that eligibility for coverage under another group health plan would not terminate eligibility for the subsidy if the other group health plan provides only dental, vision, counseling, or referral services, is a health flexible spending account or health reimbursement arrangement, or is coverage for treatment that is furnished in an on-site medical facility maintained by the employer that consists primarily of first-aid services, prevention and wellness care, or similar care.

***Income includability.*** Any premium subsidy provided is excluded from the gross income of the covered employee and any assistance eligible individuals under new IRC §139C.

***High earners must give back premium subsidy.*** ARRA contains an income threshold as an additional condition on an individual's entitlement to the premium subsidy during any taxable year. The income threshold is based on the modified AGI of an individual for the taxable year in which the subsidy is received (i.e., either 2009 or 2010) with respect to which the assistance eligible individual is the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. Modified AGI for this purpose has the same meaning as it does for the "Making Work Pay" tax credit discussed above.

If the premium subsidy is provided and the taxpayer's modified AGI exceeds $145,000 (or $290,000 for joint filers), then the amount of the premium subsidy for all months during the taxable year must be repaid. The mechanism for repayment is an increase in the taxpayer's income tax liability for the year equal to such amount. For taxpayers with modified AGI between $125,000 and $145,000 (or $250,000 and $290,000 for joint filers), the amount of the premium subsidy for the taxable year that must be repaid is reduced proportionately. The income threshold is applied separately to each taxable year.

An individual may make a permanent election to waive the right to the premium subsidy for all periods of coverage if the individual feels they will not be eligible for the subsidy because their modified AGI will exceed the threshold. This waiver applies to all periods of coverage (regardless of the tax year of the coverage) for which the individual might be entitled to the subsidy. The premium subsidy for any period of coverage cannot later be claimed as a tax credit or otherwise be recovered, even if the individual later determines that the income threshold was not exceeded for a relevant tax year. This waiver is made separately by each qualified beneficiary (who could be an assistance eligible individual) with respect to a covered employee.

***Reimbursement of group health plans.*** The ARRA provides that the "person to whom premiums are payable" will be reimbursed for the 65% discount on the premium for COBRA continuation coverage that is not paid by an assistance eligible individual. The person to whom COBRA premiums are payable is either:

- the multiemployer group health plan,

- the employer maintaining the group health plan, or
- the insurer providing coverage under the group health plan.

The plan or employer is not eligible for subsidy reimbursement, however, until it has received the reduced premium payment from the assistance eligible individual.

To the extent that the person (i.e., entity) receiving COBRA premium payments has liability for income tax withholding from wages or FICA taxes with respect to its employees, the entity will be reimbursed by treating the amount that is reimbursable as a credit against its liability for these payroll taxes. To the extent that the reimbursable amount exceeds the amount of the entity's payroll tax liability, the Treasury Secretary will reimburse the entity for the excess directly.

Any entity entitled to a premium reimbursement must submit reports at the time and in the form required by the Secretary, including:

- an attestation of the involuntary termination of employment of each covered employee on the basis of whose termination entitlement to reimbursement of premiums is claimed,
- a report of the amount of payroll taxes offset for a reporting period and the estimated offsets of such taxes for the next reporting period, and
- a report containing the TINs of all covered employees, the amount of the subsidy reimbursed for each covered employee and qualified beneficiaries, and a designation for each covered employee as to whether the reimbursement is for coverage of one individual or more than one individual.

The entity filing for reimbursement of the COBRA premium 65% discount is treated as having paid that amount in payroll taxes on the day the 35% premium payment is received from the assistance eligible individual. Therefore, any reimbursement for an amount in excess of the payroll taxes owed by the entity is treated in the same manner as an overpayment of payroll taxes and will be credited or refunded by the IRS.

On the other hand, any overstatement of such a reimbursement will be treated as an underpayment of payroll taxes, and the IRS can assess appropriate penalties for failing to truthfully account for the reimbursement. But the conference report notes that it is not intended that any portion of the reimbursement be taken into account when determining the amount of any penalty to be imposed against any person who is required to collect, truthfully account for, and pay over any tax under IRC §6672 (i.e., the "trust fund" or "100%" penalty).

***Effective date.*** The COBRA premium discount provision applies to periods of coverage beginning after February 17, 2009.

**Parity for mass transit fringe benefits**

ARRA equalizes the monthly exclusion from gross income for employer-provided parking and commuter transportation (transit pass and vanpool) benefits. The provision is effective from March 1, 2009, through December 31, 2010. This means that transit benefits will be reset at $230 per month from March - December 2009 and indexed equally with parking benefits for 2010.

**Child support matching funds for states**

ARRA resumes the federal matching of incentive funding that state child support enforcement agencies reinvest back into their enforcement programs, which was cut by the Deficit Reduction Act of 2005 (see PAYROLL CURRENTLY, Issue No. 6, Vol. 14). The resumption is temporary – from October 1, 2008, through September 30, 2010 (Fiscal Years 2009 and 2010). *Note:* The APA has lobbied on behalf of restoration of this funding, which provides much needed revenue to the state agencies, including funds to hire employees who help answer employers' questions (see "Inside Washington," for March and November 2007).

**Earned Income Tax Credit**

ARRA increases the EITC percentage for families with three or more qualifying children to 45% for 2009 and 2010. For example, in 2009 taxpayers with three or more qualifying children can claim a credit of 45% of earnings up to $12,570, resulting in a maximum credit of $5,656.50.

ARRA also increases the threshold phase-out amounts for married couples filing joint returns to $5,000 above the threshold phase-out amounts for singles, surviving spouses, and heads of households for 2009 and 2010. For example, in 2009 the maximum credit of $3,043 for one qualifying child is available for those with earnings between $8,950 and $16,420 ($21,420 if married filing jointly). The credit begins to phase out at a rate of 15.98% of earnings above $16,420 ($21,420 if married filing jointly). The credit phases out to $0 at $35,463 of earnings ($40,463 if married filing jointly). The $5,000 amount will be indexed for inflation in 2010.

☞ **AEIC TABLES TO CHANGE —** The IRS will issue new tables for calculating the Advance Earned Income Credit for the remainder of 2009 because of the increase in the phase-out threshold for a married couple filing jointly to $40,463 from $38,583. However, the maximum amount of the AEIC for 2009 will remain at $1,826.

**Delay of withholding tax on government contractors**

IRC §3402(t) generally requires information reporting and withholding at the rate of 3% on payments to persons providing property or services to a state or local government entity with $100 million or more of covered annual expenditures, effective for payments made after December 31, 2010. ARRA delays the effective date of §3402(t) for one year, to payments made after December 31, 2011.

**Suspension of tax on UC**

ARRA provides that up to $2,400 of unemployment compensation benefits received under federal or state law in 2009 are not subject to federal income tax.

**Work Opportunity Tax Credit expansion**

ARRA creates a new targeted group – unemployed veterans and disconnected youth – who begin working for the employer in 2009 or 2010. An unemployed veteran is someone who is certified by the designated local agency as:

- having served on active duty (other than for training) in the Armed Forces for more than 180 days or having been discharged or released from active duty in the Armed Forces for a service-connected disability;
- having been discharged or released from active duty in the Armed Forces during the five-year period ending on the hiring date; and
- having received unemployment compensation under state or federal law for at least four weeks during the one-year period ending on the hiring date.

A disconnected youth is an individual certified by the designated local agency as someone who is:

- 16 - 24 years old on the hiring date;
- not regularly attending any secondary, technical, or post-secondary school during the six-month period preceding the hiring date;
- not regularly employed during the six-month period preceding the hiring date; and
- not readily employable by reason of lacking a sufficient number of skills.

*Note:* a low-level of formal education may satisfy the requirement that an individual is not readily employable by reason of lacking a sufficient number of skills. ■

## Nine Federal Agencies, U.S. Congress, and Industry Experts to Offer Insights at APA's Capital Summit

On March 19-20, the American Payroll Association will host the 2009 *Capital Summit*, at the Omni Shoreham Hotel in Washington, D.C. Policy-makers will discuss the latest and still-developing legislative and regulatory issues of interest to payroll professionals.

Topics will include the delivery of the economic stimulus through paychecks; changes to Form 941 for the first quarter; the revised Form I-9 and changes to the lists of documents proving work authorization; new rules for electronic payments for payroll, pensions, and accounts payable; and other payroll-related proposals from the Obama administration and the new Congress.

**National Taxpayer Advocate to make APA debut**

Attendees will have the opportunity to hear from and express their concerns to representatives from several areas of the IRS and the Department of the Treasury, the House Ways and Means Committee, the Federal Deposit Insurance Corporation, the Office of Foreign Assets Control, the Social Security Administration, the Department of Labor, the Office of Child Support Enforcement, U.S. Citizenship and Immigration Services, and U.S. Immigration and Customs Enforcement.

Nina Olson, the National Taxpayer Advocate, will appear for the first time at an APA event and will discuss her legislative proposals to Congress, such as withholding income tax from payments to independent contractors.

Most of the presentations will be made by panels of speakers, often including APA members and other industry experts who advocate for the payroll community with the federal government.

To register or obtain more information, call APA Membership Services at 210-224-6406, 8:00 a.m. – 6:00 p.m. CT, M-F, or visit www.americanpayroll.org. ■

## Award of $35 Million to Family Dollar Store Managers for FLSA Overtime Violations Is Affirmed

The Eleventh Circuit Court of Appeals has affirmed an award of more than $35 million in overtime pay and liquidated damages to 1,424 current and former store managers of Family Dollar Stores, Inc. The court said the store managers, who routinely worked between 60 and 70 hours per week, were not executive employees exempt from the overtime requirements of the Fair Labor Standards Act (FLSA) [*Morgan v. Family Dollar Stores, Inc.*, 551 F.3d 1233 (11th CA, 12-16-08)].

**Background**

Family Dollar operates more than 6,000 discount stores across the U.S. Stores are grouped into five divisions (each headed by a vice president), 22 regions (each supervised by a regional vice president), and 380 districts (each supervised by a district manager). A district manager is responsible for the operations of 10-30 stores. Each store has a store manager, an assistant manager, and clerical employees. The only store employees treated as FLSA-exempt were the managers.

☞ **WHAT THE LAW SAYS** – The FLSA executive exemption applies to an employee: (1) who is paid a salary of at least $455 per week, not including board, lodging, or other facilities; (2) whose primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision of the enterprise; (3) who customarily and regularly directs the work of two or more other employees; and (4) who has the authority to hire or fire other employees or whose recommendations in this area are given particular weight (see *The Payroll Source®*, p. 2-12). Here, the first requirement for exemption was not in dispute because the managers earned an average salary of $600 a week.

**Primary duty of management**

The following factors are important when determining whether an employee's primary duty is management: (1) the amount of time spent in the performance of managerial duties; (2) the relative importance of the managerial duties as compared with other types of duties; (3) the employee's relative freedom from supervision; and (4) the relationship between the employee's salary and the wages paid to other employees for the kind of nonexempt work performed by the employee.

***Time spent performing managerial duties.*** The store managers spent 80-90% of their time performing nonexempt manual labor, such as stocking shelves, unloading trucks, running cash registers, and cleaning the parking lots and bathrooms. The court explained that an employee who spends less than 50% of his or her time on management duties can still be considered to have a primary duty of management if the other factors support that conclusion, but here they all showed that the managers' primary duty was not management.

***Relative importance of managerial duties.*** Although the managers had some management duties, Family Dollar explicitly required them to perform the work of stock clerks and cashiers. On days when trucks delivered merchandise to the store, the manager spent the entire day doing manual labor. "Rather than treat these manual tasks as an incidental part of a managerial job, Family Dollar described them as essential."

***Relative freedom from supervision.*** The managers had little freedom from direct supervision. The district managers enforced Family Dollar's elaborately detailed store operating procedures and closely supervised every aspect of store operations. District managers: reviewed each store's inventory orders and net sales figures; monitored each store's weekly payroll; controlled hourly rates and pay raises; gave managers "to-do" lists; and controlled the selection, pricing, and sale of merchandise.

***Relation between manager's salary and nonexempt employee wages.*** Compared to the wages of an assistant store manager, the highest paid nonexempt employee in a store, the compensation of a manager working 70 hours a week exceeded the assistant manager's wages by less than a dollar per hour. A manager working 60 hours a week earned only two or three dollars an hour more than an assistant manager. The average annual bonus paid to managers was not significant because it meant only $.58 per hour more for a manager working 60 hours a week and $.49 per hour more for a manager working 70 hours a week.

**Directing the work of two or more employees**

In determining whether the managers customarily and regularly directed the work of two or more employees, the court looked at whether the store managers supervised 80 subordinate hours of employee work per week at least 80% of the time, rejecting the argument that the determination should have been based on the company's definition of full-time employment as a 30-hour workweek. Additionally, the court rejected Family Dollar's argument that the determination should have been based on the average percentage of all 1,424 store managers as a group, because the company provided payroll records and summaries about each manager showing that 163 of them failed to meet this requirement for exemption.

**Hiring and firing employees**

District managers closely supervised the hiring and firing of store employees. An assistant manager could not be hired without an interview and approval from a district manager. Store managers interviewed and recommended hourly store associates for hire, but they could not fill these positions without district manager approval. Only the district manager had the authority to terminate employees. Although district managers often followed store manager recommendations on hiring and firing, company policy did not require that manager recommendations be given any particular weight.

**Willfulness**

An employer that willfully violates the FLSA is subject to a three-year statute of limitations on violations instead of the usual two-year limit. Here, the court affirmed that a three-year period was appropriate because the FLSA violations were willful. Family Dollar had a company-wide policy of treating store managers as exempt executives, but no one could identify the source of the policy. The company never made an attempt to determine if the store managers were actually exempt executive employees. Moreover, there was evidence that Family Dollar's executives knew that store managers spent most of their time performing non-managerial duties.

**Liquidated damages**

An employer violating the FLSA (i.e., required to pay back minimum wages and overtime) must pay an additional equal amount in liquidated damages unless it can show good faith and a reasonable basis for believing that it was not in violation of the FLSA. Family Dollar did not act in good faith because its FLSA violations were willful. Accordingly, the liquidated damages award was appropriate. ■

## SIFL Rates for 1st Half of 2009 Announced

The Standard Industry Fare Level (SIFL) rates and the terminal charge for the period January 1, 2009 – June 30, 2009, have been issued. SIFL rates and the terminal charge are factors used to calculate the value of personal flights on employer-provided or commercial aircraft for purposes of federal income, FICA, and FUTA taxes.

For the first half of 2009, the terminal charge has increased to $45.41 (from $42.26). The SIFL rates have also increased to: $0.2484 (from $0.2312) per mile for the first 500 miles; $0.1894 (from $0.1763) per mile for miles 501 to 1,500; and $0.1821 (from $0.1695) per mile for miles over 1,500. ■

## Court Affirms Award of Liquidated Damages for Overtime Violations at Famous Dave's Restaurants

After investigating five Omaha area Famous Dave's restaurants, the U.S. Department of Labor (DOL) sued Barbeque Ventures of Nebraska, LLC (owner of four of the restaurants), and Old Markets Ventures, LLC (owner of the fifth restaurant), for violating the Fair Labor Standards Act (FLSA) by allowing employees to work at different stores but not combining their weekly hours worked for overtime purposes. A U.S. District Court ordered the companies to pay 25 employees overtime compensation, liquidated damages, and post-judgment interest (see PAYROLL CURRENTLY, Issue No. 2, Vol. 16). On appeal, the companies argued that the award of liquidated damages was improper, but the Eighth Circuit Court of Appeals affirmed the lower court [*Chao v. Barbeque Ventures, LLC*, No. 08-1284, 2008 U.S. App. LEXIS 24674 (8th CA, 11-28-08)].

An employer violating the FLSA (i.e., required to pay back minimum wages and overtime) must pay an additional equal amount in liquidated damages unless it can show good faith and a reasonable basis for believing that it was not in violation of the FLSA.

The Eighth Circuit affirmed that liquidated damages were warranted in this case because the companies could not show that they acted in good faith. (1) The argument that the owners of Barbeque Ventures and Old Market Ventures did not have specific knowledge that employees were working at multiple locations was rejected, in light of their "sophistication." Because they had significant other restaurant experience and their managers knew what was occurring, the court said they did not meet their burden of showing an "honest intention" to ascertain and follow the FLSA's requirements. (2) The argument that no employees complained about overtime pay was rejected. "The fact that an employer has broken the law for a long time without complaints" from employees does not demonstrate good faith under the FLSA. (3) Finally, the argument that the owners had hired a payroll service provider that did not track employees' work at different locations was rejected. Delegating the payroll function does not satisfy the FLSA. "The duty rests on the employer to inquire into the conditions prevailing in his business," said the court. ■

## IRS Reissues 2009 Form W-5 With Corrections

The IRS has posted a note on its website [www.irs.gov/formspubs/article/0,,id=109875,00.html (2-2-09)] advising taxpayers that the 2009 Form W-5, *Earned Income Credit Advance Payment Certificate*, has been reissued. Anyone who downloaded the form before January 30 is alerted that it has been modified.

(1) On page 1, a section has been added as follows:

*What's new*

*Definition of qualifying child revised. The following changes have been made to the definition of a qualifying child.*

• *Your qualifying child must be younger than you.*

• *A child cannot be your qualifying child if he or she files a joint return, unless the return was filed only as a claim for refund.*

• *If the parents of a child can claim the child as a qualifying child but no parent claims the child, no one else can claim the child as a qualifying child unless that person's AGI is higher than the highest AGI of any parent of the child.*

(2) On page 3, item 2 under "Who Is a Qualifying Child?" has been revised to read as follows:

*The child is younger than you, and at the end of 2009, the child is under age 19, or a full-time student under age 24, or any age and permanently and totally disabled.*

The corrected version of Form W-5 is available on the APA website at www.americanpayroll.org/members/Forms-Pubs/#tax. ■

## FLSA Taxicab Exemption Did Not Apply to Airport Shuttle Driver

The Eleventh Circuit Court of Appeals has vacated a U.S. District Court ruling (see PAYROLL CURRENTLY, Issue No. 22, Vol. 16), and has said that Steven Abel, an airport shuttle service driver for Southern Shuttle Services, Inc., was entitled to overtime pay under the Fair Labor Standards Act (FLSA) because he was not covered by the "taxicab" exemption [*Abel v. Southern Services, Inc.*, No. 08-13412, 2008 U.S. App. LEXIS 24394 (11th CA, 11-28-08)].

The overtime requirements of the FLSA do not apply to "any driver employed by an employer engaged in the business of operating taxicabs" (29 USC §213(b)(17)), but the Act does not define "taxicab" or "taxicab operator." However, the Department of Labor (DOL) *Field Operations Handbook* (¶24h01) says that the "business of operating taxicabs" consists normally of common carrier transportation in small motor vehicles of persons and the property they carry to any requested destination in the community. A taxicab operates without fixed routes or contracts for recurrent transportation, and serves the "predominantly local transportation need" of the community. Taxicab operations may include occasional and unscheduled trips to or from transportation terminals as requested by individual passengers.

The Eleventh Circuit said Southern Shuttle's vans were not taxicabs as commonly understood or as described in the DOL handbook. (1) Shuttle trips to and from airports were neither occasional nor unscheduled. Every shuttle trip was either to or from an airport and was scheduled. Taxicabs carry passengers to any requested destination, but one destination (area airports) of the shuttles was always fixed, and there were scheduled stops on a route determined by the dispatch office. (2) Unlike taxicabs, the vans offered "shared ride" transportation with multiple unaffiliated passengers. Most passengers were not taken directly to their destination, but had to wait through several stops as other passengers were picked up or dropped off. (3) The vans could carry up to 10 passengers; they were larger than a typical taxicab. (4) All three counties in which Southern Shuttle operated defined a taxicab as a vehicle equipped with a meter, but the vans were not equipped with taxi meters. (5) Finally, Southern Shuttle did not call itself a taxicab operator or refer to its vehicles as taxicabs, and it provided no proof that it complied with municipal taxicab regulations. ■

## IRS Issues Guidance on New Nonqualified Deferred Compensation Provision

The IRS has issued a notice providing interim guidance on the application of IRC §457A to nonqualified deferred compensation plans of nonqualified entities [Notice 2009-8,1-8-09; www.irs.gov/pub/irs-drop/n-09-08.pdf].

### Background

Section 457A – which was enacted October 3, 2008, as part of the Emergency Economic Stabilization Act of 2008 (see PAYROLL CURRENTLY, Issue No. 21, Vol. 16) – generally provides that any compensation that is deferred under a nonqualified deferred compensation plan of a nonqualified entity is includible in gross income when there is no substantial risk of forfeiture of the right to such compensation (unless the amount of the compensation is not determinable). This provision applies in addition to §409A.

### Definitions

Notice 2009-8 provides that for purposes of §457A, the term "nonqualified deferred compensation plan" has the same meaning as provided under §409A(d), with certain modifications. For purposes of §457A, the term "nonqualified entity" means (a) any foreign corporation unless substantially all of its income is (i) effectively connected with the conduct of a trade or business in the U.S., or (ii) subject to a comprehensive foreign income tax, and (b) any partnership unless substantially all of its income is allocated to persons other than (i) foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax, and (ii) tax exempt organizations.

### Questions and answers

Notice 2009-8 includes 27 questions and answers (with many examples) covering:

- When compensation is includible in gross income under §457A;
- The definitions of "nonqualified deferred compensation plan" and "substantial risk of forfeiture" for purposes of §457A;
- The short-term deferral exception;
- Service providers covered by §457A;
- The definition of a "nonqualified entity";
- Calculating the amount includible in income under §457A;
- Deferred amounts that are "not determinable";
- Applicable effective dates; and
- Coordination with §409A.

### Effective date

Until further guidance is issued, taxpayers may rely on the guidance provided in Notice 2009-8 for purposes of §457A effective from October 3, 2008. Further guidance will be prospective and will not apply to a service provider's taxable years beginning before the issuance of such guidance.

### Comments

Comments on Notice 2009-8 are invited. Send written comments to: CC:PA:LPD:PR, Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: Notice.comments@irscounsel.treas.gov. Be sure to reference "Notice 2009-08." ■

## Wage & Hour Roundup

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

**Pre- and post-shift time: compensable time**

Nestle Prepared Foods Co., a division of Nestle USA, headquartered in Glendale, California, has paid over $5 million in back wages to more than 6,000 current and former employees. Wage-Hour investigators found that production, maintenance, and cleaning workers employed at facilities in Arkansas, California, and Utah – manufacturing products such as Hot Pockets, Lean Cuisine, and Stouffers frozen foods – were not paid for time spent putting on required equipment and clothing and removing it before and after their shifts.

**Fixed workweek: overtime**

Sandia Corp., doing business as Sandia National Laboratory in Albuquerque, New Mexico, has agreed to pay $2,077,248 in back overtime wages to 2,657 research employees. A Wage-Hour investigation found that the company failed to establish a fixed workweek, resulting in employees not receiving complete wages for overtime hours worked.

**Hazardous work and long hours: child labor**

The Department of Labor has assessed civil money penalties of $47,575 against Coney Island in Cincinnati, and Kings Island and three Kings Island onsite park vendors in Kings Mill, Ohio, for violations of the FLSA's child labor provisions involving 34 employees. Wage-Hour investigators found that the amusement parks and vendors Kaman's Art Shoppes, Chick-Fil-A, and Midwest Beverage Co. allowed employees under the age of 18 to load and operate trash compactors in violation of a hazardous occupation order, and some employees under the age of 16 to work beyond the hours and times permitted. ■

## Attorneys' Fees Not Income to Employees in Class Action Lawsuit

In a private letter ruling, the IRS has ruled that attorneys' fees paid in connection with the settlement of a class action lawsuit were not includible in the gross income of the class members and were not subject to information reporting or federal employment taxes [LTR 200906010, 10-24-08; www.irs.gov/pub/irs-wd/0906010.pdf].

**Employer settles vacation pay suit**

Employees of a corporation sued their employer for unpaid vacation pay and vacation leave. They hired an attorney and entered into a fee arrangement providing that if the case was certified as a class action, the attorneys' fees would be set by the court.

The court certified the case as a class action lawsuit, and the parties agreed to settle. In approving the settlement, the court awarded attorneys' fees to the lawyers for the class. The amount otherwise payable to the employees was reduced by the amount of the attorney fee award, which was paid to class counsel prior to distribution of the remainder of the settlement amount to the class members.

**Fees aren't income to class members**

***Gross income.*** The IRS determined that the payment of attorneys' fees to class counsel in this situation was similar to a situation discussed in Revenue Ruling 80-364 (1980-2 CB 294). The situation discussed there involved the settlement of a lawsuit brought by a union against an employer to enforce a collective bargaining agreement. In the court-approved settlement, the employer paid the union 40x in full settlement of all claims. After paying out 6x in attorneys' fees, the union distributed 34x to the employees for back pay. The ruling concluded that the portion of the settlement paid by the union for attorneys' fees was a reimbursement for expenses incurred by the union and was not remuneration to the individual employees. The ruling held that the attorneys' fees were not includible in the gross income of the union members and were not wages for purposes of federal employment taxes.

Here, the attorneys' fees were awarded by the court from the class-wide settlement fund. Accordingly, said the IRS, the attorneys' fees paid to class counsel pursuant to the settlement agreement were not income to the class members.

***Information reporting.*** The IRS notes that IRC §6041 – which requires information reporting by "all persons engaged in a trade or business" in connection with payments of income of $600 or more – does not define "income," but says that "what is referred to is gross income." Here, for example, §6041 would require an employer to report only those payments of at least $600 that are includible in class members' gross income.

However, note that the amounts paid from the settlement fund as attorneys' fees are not income to the class members. Therefore, because "income" under §6041 means only income includible in gross income, the payment of attorneys' fees is not subject to information reporting to any class member under that section.

***Employment taxes.*** The IRS notes that for FICA, FUTA, and federal income tax withholding purposes, the term "wages" means remuneration for employment or services performed for an employer. Here, however, the attorneys' fees are not remuneration to the class members and therefore are not wages for purposes of federal employment taxes. ■

## Managers Participating in Training Program Don't Lose FLSA-Exempt Status

In a Wage-Hour opinion letter, the U.S. Department of Labor (DOL) advises that store managers do not lose their exempt status under the Fair Labor Standards Act (FLSA) when participating in a training program designed to make them eligible for a promotion [W-H Op. Ltr., FLSA2008-19 (12-19-08)].

The store managers are FLSA-exempt executive employees supervised by an area sales manager. Each year high-performing store managers are selected to participate in a seven-week training program that will make them eligible for promotion to area sales manager. During the first week of training, the trainee performs little exempt work, and performs exempt work less than 50% of the time during the first few weeks. Trainees who successfully complete the training program return to their store manager positions until an area sales manager position becomes available.

The DOL explains that in these circumstances, the trainees are already employed in exempt positions and are temporarily reassigned to train for a different exempt position. The fact that the store managers do not perform significant amounts of exempt work during some of the weeks of training does not cause them to lose their exempt status. The primary duty test

for executives need not be met each and every workweek in all cases.

Moreover, the training program itself is not an employment position at the company and does not involve work that would otherwise be performed by nonexempt workers. Nor is it reasonable to conclude that the store managers' primary duty changes during the weeks of training. These employees remain exempt during the training period because their primary duty continues to be that of an exempt store manager. ■

## STATE AND LOCAL NEWS

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**UI Reserves Dangerously Low in Several States – What Will This Mean for Payroll?**

In December 2008, the unemployment rate increased for every state [U.S. Department of Labor, Bureau of Labor Statistics, News Release, 1-27-09]. With more workers filing for unemployment insurance (UI) benefits, many state UI trust funds are in a recession. As of 1-30-09, California, Indiana, Kentucky, Michigan, New York, Ohio, and South Carolina have outstanding loans from the Federal Unemployment Account (FUA). Under the joint federal/state UI system, states with a high rate of unemployment and difficulty meeting their benefit obligations can borrow money from the FUA to pay benefits. If loans taken out during one year are not repaid by the end of the following year, the FUTA credits for employers in those states are reduced, with the extra FUTA taxes applied against each state's loan balance (see *The Payroll Source®*, p. 7-8). For 2008, there were no credit reduction states, but that may change in the future. Employers in credit reduction states would see their effective FUTA tax rate increased.

It remains to be seen how these and other states will deal with UI trust fund insolvency as new federal and state legislative sessions get underway. Some states may decide to increase their taxable wage bases. New York, for example, has a low taxable wage base ($8,500) compared to its New Jersey neighbor ($28,900). Other states may decide to increase employer tax rates or cut benefits, or a combination of all of these.

**Alabama**

***Payroll service provider rule amended for third-party bulk filers.*** Effective 2-10-09, a "third-party bulk filer" includes any person who is registered to file returns and pay certain taxes, including withholding taxes, on behalf of multiple taxpayers. Previously, the definition did not include any person who provided payroll tax filing and payment services to one or more employers. A person must not act as a third-party bulk filer unless the person is registered with the Department of Revenue (DOR) for the purpose of electronically filing returns and payments. If the DOR determines that a third-party bulk filer is not substantially complying with the electronic filing requirements, it may revoke the registration and notify the clients of the revocation [Ala. Adm. Code §810-1-6-.13].

**Pennsylvania**

***Timetable for implementing new EIT countywide collection system issued.*** The Department of Community and Economic Development has issued a timetable for implementing the new earned income tax (EIT) countywide collection system – with fewer tax collectors (from 560 to 69) and uniform withholding and remittance requirements – by 2012. The new system is being implemented as a result of reform legislation enacted in July 2008 (Act 32; see PAYROLL CURRENTLY, Issue No. 14, Vol. 16). View key implementation deadlines and frequently asked questions about the new system at www.newpa.com/get-local-gov-support/tax-information/dceds-eit-collection-initiative/index.aspx.

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