



PAYROLL CURRENTLY

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IRS Commissioner Asks Congress to Change Law on Cell Phones

On June 16, IRS Commissioner Doug Shulman issued a statement asking that Congress “act to make clear that there will be no tax consequences to employers or employees for personal use of work-related devices such as cell phones provided by employers” [www.irs.gov/newsroom/article/0,,id=209795,00.html].

The statement follows the recent issuance of IRS Notice 2009-46, requesting comments on several proposals to simplify the procedures by which employers substantiate an employee’s business use of employer-provided cell phones or other similar equipment (see **PAYROLL CURRENTLY**, Issue No. 12, Vol. 17).

Commissioner Shulman’s statement explains that the current law, which has been on the books for many years, is burdensome, poorly understood by taxpayers, and difficult for the IRS to administer consistently. Although the changes proposed in Notice 2009-46 would add clarity, “the current

law will inevitably leave widespread confusion among employees and businesses.” The passage of time, advances in technology, and the nature of communication in the modern workplace have rendered this law obsolete, he concludes.

Note: Under current law, if an employer provides a cell phone to an employee and pays the costs of using the cell phone, the employee receives a fringe benefit. To the extent the employee uses the employer’s cell phone for business purposes, the fair market value of such use qualifies as a working condition fringe benefit excludable from the employee’s gross income and the cell phone expense is a deductible business expense for the employer, provided that the substantiation requirements of IRC §274(d) are met. However, to the extent the employee uses the cell phone for personal purposes, the fair market value of such use is includable in the employee’s gross income. ■

IRS Says Two Forms W-2c Needed for an Incorrectly Reported Tax Year or EIN

In the Summer 2009 issue of the *SSA/IRS Reporter* (www.irs.gov/pub/irs-pdf/p1693.pdf), the IRS explains that to correct an incorrect tax year or employer identification number (EIN) on Form W-2 (*Wage and Tax Statement*), two Forms W-2c (*Corrected Wage and Tax Statement*) should be filed:

- File one Form W-2c showing the incorrect tax year or EIN and reducing the previously reported money amounts to zero.
- File a second Form W-2c reporting the money amounts (showing zeros in the “previously reported” columns) in the correct year or with the correct EIN. ■

Following IRS Regulations, Eighth Circuit Says Medical Residents Did Not Qualify for the FICA Student Exception

In 2003, a federal district court in Minnesota ruled that the “student exception” from FICA (social security and Medicare) taxes applied to residents in the Mayo Clinic’s graduate medical education program (2003 U.S. Dist. LEXIS 13603). In response to that and other similar decisions, the IRS issued revised regulations in 2004 restricting the scope of the FICA student exception in connection with the performance of services in the nature of on-the-job training and making it clear that the exception does not apply to medical interns and residents (see [PAYROLL CURRENTLY, Issue No. 1, Vol. 13](#)).

After the revised regulations became effective on April 1, 2005, the Mayo Clinic withheld and paid FICA taxes on the stipends paid to its medical residents, and sued to obtain a refund. In 2007, the Minnesota federal district court said the revised regulations were invalid interpretations of the IRC section setting out the exception, applied the FICA student exception to the residents, and ordered a refund of the FICA taxes paid (see [PAYROLL CURRENTLY, Issue No. 18, Vol. 15](#)). The Eighth Circuit Court of Appeals has now reversed that decision and said the revised regulations are valid, creating a split among the federal courts of appeals on this issue [*Mayo Foundation for Medical Education and Research v. U.S.*, Nos. 07-3242 and 08-2193, 2009 U.S. App. LEXIS 12640 (8th CA, 6-12-09)].

The FICA student exception

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

Residents were not students

Before they were revised, IRS regulations provided that

student status was to be determined on the basis of the relationship of the employee with the organization for which services were performed. An employee performing services while employed by an SCU incident to, and for the purpose of, pursuing a course of study was considered a student. The revised IRS regulations modify the definition of “student” by providing that an employee whose normal work schedule is 40 hours or more per week is considered a “full-time employee,” and such employee’s services are not incident to, and for the purpose of, pursuing a course of study.

In upholding the revised regulations, the court explained that 26 USC §3121(b)(10) is silent or ambiguous on the question of whether a medical resident working for a school full-time is a “student who is regularly enrolled or attending classes.” The IRS has never agreed that a medical student working 40 hours or more per week and earning around \$50,000 a year qualified for the exception. In fact, the history of the exception shows that it did not extend to full-time student employees. The prior regulations governing the FICA student exception were a permissible interpretation of §3121(b)(10), said the court, but so are the revised regulations. In this case, the Mayo Clinic’s medical residents did not qualify for the student FICA exception because they worked more than 40 hours per week and were therefore full-time employees, not students.

☞ **CIRCUIT COURTS ARE SPLIT** – In this case, the Eighth Circuit Court of Appeals upheld the 2004 IRS regulations. As we reported recently, however, the Second and Sixth Circuits have rejected the IRS position (see [PAYROLL CURRENTLY, Issue No. 9, Vol. 17](#)) in cases with similar facts. The Seventh and Eleventh Circuits also reject the IRS position (see *The Payroll Source*®, p. 6-53). This disagreement among the circuits may mean that the U.S. Supreme Court will agree to hear a case on the issue in order to resolve it. ■

IRS Issues Guidance on Expanded Work Opportunity Tax Credit

The American Recovery and Reinvestment Act of 2009 (see [PAYROLL CURRENTLY, Issue No. 4, Vol. 17](#)) added unemployed veterans returning to civilian life and “disconnected youth” to the list of those covered by the Work Opportunity Tax Credit (WOTC). The WOTC now offers tax savings to businesses that hire workers belonging to any of 12 targeted groups, including unemployed veterans and disconnected youth.

Though eligible unemployed veterans and disconnected youth who begin work anytime during 2009 or 2010 may qualify a business for the credit, certification by the state workforce agency is required. Newly revised Form 8850 (*Pre-Screening Notice and Certification Request for the Work Opportunity Credit*), available at www.irs.gov/pub/irs-pdf/f8850.pdf, is used by employers to request certification from their state workforce agency.

Note: The WOTC offers tax savings to businesses that hire workers belonging to any of 12 targeted groups, including

unemployed veterans and disconnected youth. The other 10 include people ages 18 to 39 living in designated communities in 43 states and the District of Columbia, Hurricane Katrina employees, recipients of various types of public assistance, and certain veterans, summer youth workers, and ex-felons. The *Instructions for Form 8850* detail the requirements for each of these groups. The certification requirement applies to all groups of workers except employees who were Hurricane Katrina victims.

Special filing rule. Normally, a business must file Form 8850 with the state workforce agency within 28 days after the eligible worker begins work. But under a special rule, businesses have until August 17, 2009, to file this form for unemployed veterans and disconnected youth who begin work on or after January 1, 2009, and before July 17, 2009. Details on this special rule are provided in the *Instructions for Form 8850* (www.irs.gov/pub/irs-pdf/i8850.pdf) and in Notice 2009-28 (www.irs.gov/pub/irs-drop/n-09-28.pdf). ■

DOL Suspends Revised Temporary Agricultural Worker Visa Rules

Effective June 29, 2009, the U.S. Department of Labor (DOL) is suspending for nine months the regulations

effective January 17, 2009 (see [PAYROLL CURRENTLY, Issue No. 3, Vol. 17](#)), that modified the labor certification process

for nonimmigrant temporary or seasonal agricultural (H-2A) workers, and the enforcement of the contractual obligations applicable to employers of such workers [74 F.R. 25972, 5-29-09; <http://edocket.access.gpo.gov/2009/pdf/E9-12436.pdf>]. “To ensure continued functioning of the H-2A program,”

the DOL has reinstated the regulations in place on January 16, 2009, for a period of nine months. “After that, the Department will either have engaged in further rulemaking or lift the suspension.” *Note:* Reasons for the suspension are discussed in **PAYROLL CURRENTLY**, Issue No. 7, Vol. 17. ■

Courts Disagree on Whether FLSA ‘Outside Sales’ Exemption Applies to Pharmaceutical Sales Reps

In two recent cases, the U.S. District Court in Connecticut has ruled that the “outside sales” exemption from the minimum wage and overtime requirements of the Fair Labor Standards Act (FLSA) does not apply to pharmaceutical sales representatives (PSRs) [*Ruggeri v. Boehringer Ingelheim Pharmaceuticals, Inc.*, 585 F. Supp.2d 254 (D Conn., 11-13-08); *Kuzinski v. Schering Corp.*, No. 3:07cv233 (JBA), 2009 U.S. Dist. LEXIS 25702 (D Conn., 3-30-09)]. U.S. District Courts in New York and California, however, have ruled that PSRs are covered by the exemption [*In re Novartis Wage and Hour Litigation*, 593 F. Supp.2d 637 (SD N.Y., 1-12-09); *Yacoubian v. Ortho-McNeil Pharmaceutical, Inc.*, No. SACV 07-00127-CJC(MLGx), 2009 U.S. Dist. LEXIS 27937 (CD Cal., 2-6-09); *Delgado v. Ortho-McNeil Pharmaceutical, Inc.*, No. SACV 07-00263-CJC(MLGx), 2009 U.S. Dist. LEXIS 28810 (CD Cal., 2-6-09)].

Background

All of the PSRs in these cases performed similar duties. They visited physicians within their assigned territories to present information and distribute samples of their companies’ products. They presented “lunch and learn” events to educate physicians about the benefits of their products.

☛ **WHAT THE LAW SAYS** – To qualify for the outside sales exemption:

1. The employee’s primary duty must be:
 - a. making sales of tangible or intangible items such as goods, insurance, stocks, bonds, or real estate; or
 - b. obtaining orders or contracts for services or the use of facilities; and
2. The employee must customarily and regularly work away from the employer’s place or places of business in performing his/her primary duty (see *The Payroll Source*®, p. 2-21).

Under FLSA regulations (29 C.F.R. §541.501), a sale “includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition.”

Exemption not applicable

Ruggeri v. Boehringer Ingelheim Pharmaceuticals, Inc.

The court explained that if an employee does not make sales or obtain orders or contracts, he or she cannot be covered by the outside sales exemption because these activities must be the employee’s primary duty. Promotional work can be considered exempt sales work if it is incidental to the employee’s sales; however, promotional work incidental to sales made by someone else is not exempt outside sales work.

The court said the outside sales exemption did not apply to the PSRs because they could not make sales or obtain orders or contracts for Boehringer’s products. PSRs could not enter into contracts with physicians to write a certain number of prescriptions. Moreover, physicians could not

legally purchase the Boehringer products that PSRs discussed with them.

Boehringer argued that the exemption should apply to the PSRs because their job duties included “various indicia” of sales, which demonstrated that they were engaged in making sales. For example, PSR jobs were advertised as sales positions, they were called “salespersons,” they were provided with sales training, and they received commissions. The court said that these indicators were only relevant *after* determining that some of the work performed by the PSRs was actually outside sales, at which point the question would be whether they were incidental to exempt outside sales work.

Finally, the court rejected Boehringer’s argument that the regulatory environment in which PSRs operate should be considered in applying the outside sales exemption. “In essence, Defendant’s argument is that the court should back-fit the FLSA to the practices of the industry. To do so, however, would flip the law of this Circuit, which narrowly applies the FLSA’s overtime exemptions and imposes the burden on the employer to demonstrate that its arrangements ‘plainly and unmistakably’ fit the statute and regulations.”

Kuzinski v. Schering Corp. The court that decided the *Ruggeri* case affirmed its reasoning and said that Schering’s PSRs were not covered by the outside sales exemption. Like the *Ruggeri* PSRs, Schering’s PSRs visited physicians but did not obtain orders or contracts.

The court considered and rejected the reasoning of the courts in the *Novartis*, *Yacoubian*, and *Delgado* cases (discussed below). The FLSA and its regulations require an exempt outside sales employee to make sales and define what a “sale” is. PSRs and physicians do not have the capacity to consummate sales. PSRs provide useful information to physicians, who cannot make binding commitments that they will prescribe Schering products. In short, physicians are not Schering’s customers — wholesalers are. PSRs work to increase the market share for Schering products, but this is no different from direct-to-consumer advertising, which is also not sales activity.

Exemption applicable

In re Novartis Wage and Hour Litigation. The court in this case explained that the outside sales exemption applies to employees, “not because they ‘sell’ as that term is technically defined, but rather because they (1) generate commissions for themselves through their work and (2) work with minimal supervision, making adherence to an hours-based compensation scheme impractical.” It is also necessary, said the court, to consider the characteristics of the particular industry in determining the applicability of the sales exemption.

Here, the court concluded that the PSRs were exempt outside sales employees. PSRs “make sales in the sense that

sales are made in the pharmaceutical industry.” PSRs cannot sell to physicians, nor can physicians make commitments to purchase Novartis products. However, it is physicians, the targets of PSR marketing efforts, who have the ultimate control over the purchase of Novartis products through the prescriptions they write.

The PSRs were not engaging in nonexempt promotional work to generate sales by others because their efforts were directed to stimulating their own sales within the context of the pharmaceutical industry. The compensation structure was evidence that the PSRs were engaged in making sales even though the incentive payments did not necessarily match specific sales of products to specific PSRs. There need not be a one-to-one correspondence between sales and payments. The incentive structure clearly rewarded a PSR’s success in persuading physicians to prescribe Novartis products.

Finally, the PSRs had other characteristics traditionally associated with outside salespersons. They worked away from Novartis offices, set their own schedules, and were subject to minimal supervision.

Yacobian v. Ortho-McNeil Pharmaceutical, Inc./ Delgado v. Ortho-McNeil Pharmaceutical, Inc. The court in these cases followed *Novartis* and concluded that Ortho’s PSRs were covered by the outside sales exemption. The court reasoned that PSRs convince physicians to prescribe Ortho drugs, which meets the FLSA regulatory definition of a sale because it is an “other disposition.” It is physicians whose prescriptions drive pharmaceutical sales. The PSRs were not conducting nonexempt promotional activity to stimulate sales by others, and their duties and work conditions were the same as those of other outside sales employees. ■

FLSA Newspaper Delivery Exemption Applied to Circulation Department Employee

Charlemagne Louis-Charles was a district coordinator in the circulation department of the Sun-Sentinel Co., a Florida newspaper publisher. His duties included: recruiting, training, and supervising lower level employees; quality control and customer service; ensuring employee and independent contractor compliance with contracts, policies, and procedures; coordinating all early morning operations including newspaper distribution; delivering any route not otherwise assigned; and delivering replacement papers to customers. When Louis-Charles sued Sun-Sentinel for failure to pay overtime as required by the Fair Labor Standards Act (FLSA), the company said that he was not entitled to overtime pay because he spent a significant amount of time delivering newspapers and was therefore covered by the FLSA’s newspaper delivery exemption.

Newspaper delivery exemption

The FLSA newspaper delivery exemption applies to any employee “engaged in the delivery of newspapers to the consumer” (29 USC §213(d)). The court said that this provision is less stringent than a primary duty requirement: “In fact, it appears that so long as the employee has consistent time spent performing the exempt duty, he is

exempt from the provisions of the FLSA.” Moreover, the fact that the newspaper delivery exemption appears in the portion of the FLSA dealing with child labor does not limit its application to minors.

Regular and recurring delivery activity triggers exemption

Here, Louis-Charles spent between one and one and one-half hours delivering newspapers to consumers an average of about four times a week. Even though newspaper delivery did not take much of his time, it occurred on a regular and recurring basis. Because Louis-Charles was engaged in delivering newspapers to consumers, he was FLSA-exempt, concluded the court.

The court cautioned, however, that the newspaper delivery exemption applies only to employees who actually deliver newspapers to consumers. Time spent performing duties incidental to newspaper delivery – e.g., receiving newspapers, counting and compiling newspapers, and verifying and stocking newspaper inserts – is outside the scope of the exemption [*Louis-Charles v. Sun-Sentinel Co.*, No. 07-80621-CIV-RYSKAMP/VITUNAC, 2008 U.S. Dist. LEXIS 107135 (SD Fla., 10-3-08)]. ■

Physician Was Employee of Professional Corporation

On July 1, 2001, Walter Maimon and seven other doctors signed agreements making them equal shareholders of Dayton Head and Neck Surgeons, Inc. (DHN). The physician shareholders had different areas of specialty. They organized DHN to share overhead and operating expenses and agreed to share revenues equally.

Also on July 1, 2001, Dr. Maimon signed an employment agreement under which DHN: paid Maimon a base salary and an annual bonus; reimbursed Maimon for his continuing education expenses, hospital dues, professional memberships, and other professional expenses; provided Maimon with paid vacation time; and maintained Maimon’s malpractice insurance.

DHN issued a Form W-2 to Maimon for 2004, reporting \$409,300 as “Wages, tips, and other compensation” in Box 1. When Maimon filed his Form 1040 for 2004, he left Line 7 (“Wages, salaries, tips, etc.”) blank, and attached Schedule C,

Profit or Loss From Business, showing the \$409,300 as gross receipts or sales. Maimon also reported \$24,615 of expenses on Schedule C for legal fees in connection with a lawsuit filed against him for medical negligence and professional dues. After the IRS determined a federal income tax deficiency of \$11,793, Maimon turned to the U.S. Tax Court, arguing that he was correct in filing Schedule C and offsetting his expenses because he was an independent contractor, not an employee.

WHAT THE LAW SAYS – Factors considered in determining whether a worker is an employee include: (1) the degree of control exercised by the principal; (2) which party invests in work facilities the worker used; (3) the worker’s opportunity for profit or loss; (4) whether the principal can discharge the worker; (5) whether the work is part of the principal’s regular business; (6) the permanency of the relationship; and (7) the relationship the parties

believed they were creating. No single factor controls the determination.

Employee vs. independent contractor

Risk of loss. Maimon had some risk of loss as a shareholder if DHN operated at a loss. And the fact that he incurred a loss as a result of his malpractice settlement also indicated that he had a risk of loss. However, all other factors pointed to his status as an employee.

Degree of control. The court explained that the degree of control necessary for employee status varies with the nature of the services provided by a worker, and that a lower measure of control applies to professionals. Here, Maimon was required to work four and one-half days per week during DHN office hours; he had flexibility only with respect to his half-day off. Patients belonged to DHN, and Maimon was required to submit patient records to DHN for billing and insurance purposes.

Although Maimon exercised medical judgment when rendering services, his methods were directed by professional standards set by the medical community. However, because of the lower measure of control applicable to professionals, the fact that DHN did not control his patient diagnoses and treatments does not mean that DHN did not exercise sufficient control over Maimon to establish an employer-employee relationship.

Investment in facilities. DHN employed receptionists to schedule doctors' appointments, billed and collected money for services rendered by the doctors, maintained records and paperwork, and leased real estate that allowed doctors to provide services at five different locations. Maimon

might have provided some equipment for his work, but any investment he made was outweighed by DHN's investment in office locations, equipment, and the payment of hospital dues.

Termination rights and worker's role. Maimon's work as a physician was integral to DHN's business of providing medical services. Moreover, Maimon did not provide medical services outside of his relationship with DHN. Under the employment agreement, Maimon and DHN each had the right to terminate the agreement, with or without cause. And Maimon's initial employment contract, which was automatically renewed each year, showed that Maimon and DHN had a continuing relationship.

Intent of the parties. Maimon and DHN intended to create an employer-employee relationship. The employment agreement expressly identified Maimon as an "employee." He received employment benefits, and was reimbursed for out-of-pocket expenses. Consistent with this relationship, DHN withheld federal and state income and employment taxes, and reported these on Form W-2. DHN did not check the "statutory employee" box on Maimon's Form W-2, and refused to issue an amended form with the box checked when Maimon requested it.

Conclusion

Because Maimon was an employee and not an independent contractor, he was required to report his income on Form 1040 and could not deduct his claimed business expenses on Schedule C [*Maimon v. Commissioner*, No. 8008-07S, 2009 Tax Ct. Summary LEXIS 53 (4-20-09)]. ■

Flight Attendant's Training Time Was Not Compensable

Lauren Ulrich attended two five-week training classes given by Alaska Airlines, Inc. for prospective flight attendants. The 40 hours of training each week also included three or four in-flight training sessions. Trainees were provided housing and a meal allowance while attending training, but were not paid. After Ulrich successfully completed the program and was hired by Alaska Airlines, she sued to recover compensation for her training time under the Fair Labor Standards Act (FLSA). The question for the court was whether Ulrich was an employee when she was in the airline's training program.

☞ **TRAINEES VS. EMPLOYEES** – The court explained that a six-factor test applies in determining trainee vs. employee status, and that all six factors must be met in order for trainees not to be considered employees:

(1) the training is similar to what would be given in a vocational school or academic educational instruction (*note*: this factor was not in dispute);

(2) the training is for the benefit of the trainees or students;

(3) the trainees or students do not displace regular employees, but work under their close observation;

(4) the employer that provides the training derives no immediate advantage from the activities of the trainees or students and, on occasion, the employer's operations may actually be impeded;

(5) the trainees or students are not necessarily entitled to a job at the end of the training period; and

(6) the employer and the trainees or students

understand that the trainees or students are not entitled to wages for the time spent in training.

Ruling

The court said the training program satisfied all six factors, so program participants' time was not compensable work time under the FLSA.

Ulrich assisted with boarding, de-planing, and on-board food and beverage service under close observation by the flight attendants, picked up trash, made service announcements, and interacted with customers. She gained first-hand customer service experience that she could take to a future job at Alaska Airlines, at another airline, or even to employment in a different field.

Alaska Airlines received no immediate benefit from the trainees' work, because the airline still had to staff the airplane with a full complement of regular flight attendants. Further, in order to provide a seat for the trainees, the airline had to give up potential passenger revenue from the seats they occupied during training flights.

Before starting training, Ulrich received a "welcome" letter that included language making employment with Alaska Airlines subject to several conditions, one of which was successful completion of the training program. Moreover, Ulrich signed a training contract stating that "participation in this training program does not ensure me of an offer of employment" and specifying that no wages would be paid during training [*Ulrich v. Alaska Airlines, Inc.*, No. C07-1215RSM, 2009 U.S. Dist. LEXIS 10104 (WD Wash., 2-9-09)]. ■



STATE AND LOCAL NEWS

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Florida

Payroll debit cards allowed. Effective 7-1-09, payroll debit cards are added to the list of acceptable payment methods. Wages must be paid on demand, without discount, at an established place of business in the state (the name and address of which must appear in the payroll debit card materials). The payroll debit card must be supported by sufficient funds for at least 30 days [H.B. 569, L. 2009].

Hawaii

Withholding formulas revised. The Department of Taxation (DOT) has revised the withholding computation formulas (annualized method and alternative method) that appear in Booklet A, *Employer's Tax Guide* (Appendix I, Parts 1 and 2), to reflect increased tax rates for high-income wage earners. Booklet A will be revised with changes to the wage bracket withholding tables (in Appendix I, Part 3) in the latter part of 2010 when the standard deduction and personal exemption amounts are revised for tax year 2011 [DOT, *Supplemental Insert to Booklet A, Employer's Tax Guide*, 6-09, at www6.hawaii.gov/tax/pubs/06bk1ta_sup2009.pdf].

Maryland

Tax amnesty program established. A tax amnesty program will take place from 9-1-09 to 10-30-09, and will apply to several tax types, including withholding taxes. All civil penalties (except previously assessed fraud penalties) and half of the interest will be waived for employers that file a delinquent return and pay the tax due, or enter into an agreement with the Comptroller for payment. The tax amnesty program applies only to taxes owed on or before 12-31-08 [S.B. 552, L. 2009].

Nevada

Modified business tax rates changed; business license fee increased. Effective 7-1-09 through 6-30-11, the modified business tax (MBT) rate for employers (other than financial institutions) will be 0.5% if the total wages paid by the employer during a calendar quarter does not exceed \$62,500, and an additional 1.17% if the total wages paid during a calendar quarter exceeds \$62,500 (i.e., \$312.50 plus 1.17%). Currently, the MBT rate is 0.63% for employers; the rate for financial institutions is 2%.

Also effective 7-1-09 through 6-30-11, the fee for a state business license will increase to \$200 from \$100 [S.B. 429, L. 2009].

Vermont

Tax amnesty program established; UI taxable wage base increased. The Department of Taxes (DOT) has announced that there will be an amnesty program for all tax types beginning 7-20-09 and ending 8-31-09. The program will apply to periods for which returns were due before 1-26-09. All penalties will be waived provided proper returns are filed and the full amount of taxes and interest is paid [H.B. 441, L. 2009; DOT, *Highlights of 2009 Tax Legislation*].

Effective 1-1-10, the unemployment insurance (UI) taxable wage base will increase to \$10,000 from \$8,000 (this updates *The Payroll Source*®, p. 7-23) [H.B. 442, L. 2009].

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SPECIAL REPORT: Payroll Questions Answered by Federal Panel at APA Congress

A panel of federal agency executives answered questions submitted by participants at the American Payroll Association's 27th Annual Congress in Long Beach, California. Members of this year's panel included: Anita Bartels, Senior Program Analyst, Small Business/Self-Employed Compliance Policy, Office of Employment Tax, Internal Revenue Service; Sherri Grigsby, Manager, Employer Services Team, Office of Child Support Enforcement; Amy Lawson, Associate Chief, Verification Division, U.S. Citizenship and Immigration Services, Department of Homeland Security; Chuck Liptz, Director, Division of Electronic Services Support and Communications, Social Security Administration; and Ruben Rosalez, Deputy Regional Administrator, Western Region, Wage and Hour Division, Department of Labor.

Internal Revenue Service

Validating COBRA premium assistance tax credits

Q. How will the IRS balance or reconcile the COBRA premium assistance tax credits claimed by employers on Form 941? Could the IRS "freeze" an employer's credit? If so, how will the IRS notify the employer, and what will the employer's responsibility be in order to validate the credit?

A. We do have a process in place to validate the COBRA premium assistance claims that we get. And if a credit requires further explanation, then it will be frozen. In that case, a letter will be sent to the employer that filed the claim informing the employer that the claim is going to be reviewed and that the employer will be contacted within 30 days. The letter will also explain that an examiner is going to be assigned and that further information will be requested.

If the credit results in an overpayment, it will be applied to any outstanding tax liabilities just like any other overpayment. If there is a COBRA credit, the employer chooses to have any excess refunded, the employer has unpaid employment or income taxes and the amount of the credit is larger than the amount of the liability shown on the 941, then those outstanding liabilities will be offset against the balance due before it's refunded. If that happens, then the IRS will notify the taxpayer.

'Involuntary termination' for COBRA premium assistance eligibility purposes

Q. In order to be eligible for COBRA premium assistance, an individual must be, among other things, "involuntarily terminated." How is that defined? If we are planning to lay off a certain number of employees, and we let individuals volunteer for severance packages, will they be considered "involuntarily terminated"?

A. The official definition of "involuntary termination" is a "severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment rather than due to the employee's implicit or explicit request, where the employee was willing and able to continue performing services."

What that means is that the employer basically says, "We know you could continue doing this job, but we no longer have a job for you." The IRS always looks at facts and circumstances. But, basically, if you lay somebody off or fire them, then that constitutes involuntary termination for these purposes.

To answer the second part of the question, involuntary termination does include a termination elected by the

employee in return for a severance package or buyout if the employer indicates that after the offer period for the severance package a certain number of remaining employees in the employee's group will be terminated.

What that means is that, if you give employees a buyout offer and they know that there are going to be a certain number of layoffs regardless of whether they take it, then they can qualify for COBRA under the new rule. See the COBRA Q&As on the IRS website (www.irs.gov/newsroom/article/0,,id=204708,00.html) and Notice 2009-27 (www.irs.gov/pub/irs-drop/n-09-27.pdf) for more information.

Form W-2 and the COBRA premium subsidy

Q. Will employers be required to indicate the amount of COBRA subsidy on their employees' Forms W-2? How will the IRS know whether a taxpayer whose modified adjusted gross income is over the assistance eligibility limit needs to add an amount to his or her tax liability on a personal income tax return?

A. The decision has been made that there will be no W-2 or 1099 reporting for these subsidies. However, employers are required to keep records. For example, they have to verify that they received the 35% from each employee, they have to say when they received it, and they have to say from whom they received it. They also have to verify that they did, in fact, pay the COBRA premium to their carrier. They have to attest that the employee was involuntarily terminated. And they have to have verification of the employee's eligibility for an election of the COBRA subsidy.

We'll catch up with those employees who receive it, who may be over the income limitation, over time. We have lots of processes and procedures in place. For example, we can freeze claims that come in on 941s. And if it's not noted in the W-2s you issue, we're going to come asking you for this information. Basically, the IRS will track individuals through employer-provided information.

Employee eligibility for COBRA premium assistance more than once

Q. We just let an employee go. It was an involuntary termination, and we think he qualifies for COBRA premium assistance. However, we are aware that when he first came to work for us, he was receiving a COBRA subsidy from his former employer until he became eligible for our benefit plan. Can he benefit two times from COBRA premium assistance? If so, do we have to apply the length of time he was subsidized by his former employer against his eligibility for nine months of COBRA assistance from us?

A. See Notice 2009-27, Question and Answer 17 and Question and Answer 43. What you'll find is that an assistance eligible individual is eligible for up to nine months of premium reduction for each involuntary termination.

Reporting COBRA premium assistance on Form 941, Line 12b

Q. Form 941, Line 12b, asks for the "Number of individuals provided COBRA premium assistance" (for which the employer claims the credit on Line 12a). How should we calculate the number on Line 12b? Should it reflect the number of former employees through whom assistance is being provided, no matter how many individuals (e.g., spouses and dependents) are covered? Should it reflect the total number of individuals? What if the employee doesn't take COBRA, but

the employee's ex-spouse does and the employee's child does, and the payments are sent in separately? Does that count as 1 or 2?

A. The number entered on Line 12b should reflect the total number of assistance eligible individuals who have been provided with COBRA assistance. So you can count each assistance eligible individual who paid a reduced COBRA premium in the quarter as one individual whether or not the reduced premium was for insurance that covered more than one person (family coverage).

For example, if the reduced COBRA premium was for coverage of a former employee, his spouse, and two children, that's four people. But you would include one individual in the number entered on Line 12b for the premium assistance credit. Also, you're only going to report each individual once per quarter. The instructions for the 941 have been updated to explain this (see *PAYROLL CURRENTLY*, Issue No. 11, Vol. 17).

Making Work Pay tax credit

Q. Employees are getting extra money in their paychecks, thanks to the Making Work Pay credit. However, I understand that some taxpayers may have to pay some of this money back when they file their income tax returns. Can you explain this, and where can I direct my employees for help with their individual situations?

A. Publication 919, *How Do I Adjust My Tax Withholding?*, gives information about tax withholding. It includes a special worksheet for the Making Work Pay credit.

In certain cases – if there are two earners in the family, for example – you may want to use that worksheet to verify whether they are, in fact, having enough taken out. Under some circumstances they may come up short at the end of the year because the new withholding tables do reduce the amount of withholding that's being taken out.

Hints for completing Form 941-X

Q. In Part 1 of Form 941-X, the employer has to choose between two processes: "Adjusted Employment Tax Return" and "Refund." What is the difference between them? What if my company owes the IRS on certain taxes, but the IRS owes us on other taxes? Is it true that some months are better than others for submitting this form?

A. Under the adjustment process, an employer can self-correct an underpayment of employment taxes that was made in a previous quarter or on a previously filed employment tax return without interest. Generally, correction of an underreported amount will not be subject to interest if the employer files by the due date of the return for the period in which the employer discovers the error. So if you find the error in March, then you need to file by the due date of that 941. And you have to pay the balance due with the 941-X by the time you file the form. You have to enter the date that the error was discovered, and you have to provide in detail the grounds and facts that you rely on to support the correction.

If you are correcting an overpayment, it will generally be applied as a credit toward the employer's required employment tax deposits for the period when you file the adjusted return. So if you're filing Form 941-X to correct an overpayment using the adjustment process, then the IRS recommends that you file that form in the first two months of the quarter to ensure that we have enough time to process the credit.

Note that an employer can also use Form 941-X to claim a refund. If the claim process is used, a refund in the amount

of the overpayment will be issued to the employer. And if the employer has outstanding liabilities, then the overpayment will be applied toward those liabilities.

If you are correcting both an overpayment and an underpayment in the same period, then refer to the chart on the last page of the 941-X titled "Which process should I use?" to help you decide which process to use in your particular situation.

401(k)/403(b) plans and the intersection of annual compensation and deduction limits

Q. Does the "annual limit on compensation applicable to 401(k) and 403(b) plans under IRC §§401(a)(17), 404(1), and 408(k)(3)(c), which is currently \$245,000, mean that any earnings over that amount are not eligible for having deductions taken for these deferred compensation plans, even if the employee has not reached the deduction limit (\$16,500)? Does this affect the catch-up contribution of up to \$5,500 that one may defer if at least age 50 during the plan year?

A. The limitation means that deductions may not be taken for those deferred compensation plans from any earnings over \$245,000 even if the employee has not reached the \$16,500 deduction limit.

For example, if someone with an annual salary of \$300,000 elects a 5% deferral with the idea that he will defer \$15,000, he will max out his 401(k) at \$12,250, or 5% of \$245,000, even though he has not reached the deduction limit of \$16,500.

However, the compensation limit does not apply to the extra catch-up amount up to \$5,500 that can be deferred if the participant is at least age 50 during the plan year.

Tax deposit obligations and the exercise of nonqualified stock options at year-end

Q. Under an IRS field directive, IRS auditors will not challenge the timeliness of tax deposits related to the exercise of a nonqualified stock option, as long as the deposit is made within the appropriate amount of time (e.g., semiweekly rule or next-day rule) from a date determined by adding three business days to date of the actual exercise. What should be done, however, in the case of an exercise at the end of the year (e.g., December 30) that involves the immediate sale of some or all of the stock? The broker will issue a Form 1099-B to report the sale in the year of the exercise and sale, but the employer will report the wages on a W-2 and 941 for the following year. Won't that cause a problem for the employee's personal income tax filing?

A. The field directive is basically an administrative position on tax deposit obligations. It's not a legal position. And it doesn't address the recognition of income at all. The question itself points out the problems if you disconnect the wage event from the exercise date.

Anytime anybody earns any money, it's constructively paid when it's credited to the account set apart for the use of this person. So if the exercise is on December 30th and the stock is immediately sold, then that would be the date on which the transaction occurred. In that case, the wages should be treated as paid at exercise and reported on the fourth quarter return and on the Form W-2 for that year.

However, under the three-day administrative convenience rule, the employer would not have to make the deposit on those earnings on the spread of the exercise until three days have lapsed, which would be January 2nd. There is definitely a disconnect in that situation. Technically, it would be better if

you could do it so the money was set aside for the employee on the day of exercise, and make that the reporting date. But for the convenience of the employer, sometimes that doesn't happen.

If the employee doesn't get the money that year, then he'll report it the following year. If it goes on the employee's W-2 for the year that contains December 30th, the employee is not going to have a problem. It's going to be the employer, who may not report it until their first quarter 941 for the next year because they're making a deposit in January, that will have a reconciliation problem.

Backup withholding

Q. What should a payer do if it must make a 1099-MISC-reportable payment, but the vendor refuses to provide a taxpayer identification number (TIN) and, if we take backup withholding, won't release property for which we are responsible? Is there some other way to report the payment to the IRS? We are a collision-repair company, required by contract with certain insurance companies to repair their clients' cars. The cars are towed to us by tow companies chosen by the police at the time of the auto accident, and the tow companies demand full payment in cash before they will release a car.

A. The obligation for backup withholding applies when a taxpayer identification number is not provided by the person receiving the payment and the amount is a reportable payment – as it would be in this case – that must be reported on Form 1099-MISC. Under the Internal Revenue Code, the payer is indemnified for the amount it withholds and is liable for the amount even if it doesn't withhold.

The payment from the repair company to the towing company is outside of our scope. We don't get involved in something that's between two businesses. There isn't a lot the IRS can do about the towing company that won't release the property. All I can do is tell you what the backup withholding rules are. The bottom line is that you are required to backup withhold if you don't get the taxpayer identification number that you need.

Taxability of employer-provided clothing

Q. We provide our employees shirts and coats with our logos. Sometimes, we require them to wear these items so that they will be recognized as our employees at public events. However, they can keep this clothing and wear it whenever they want. And sometimes we give them this sort of clothing without any requirement that they wear it at an event. Are these items of clothing taxable?

A. Generally, employer-provided uniforms – and uniform allowances for that matter – are exempt from employment taxes if the uniforms are specifically required as a condition of employment and not of a type adaptable to general or continued usage outside of work.

Military differential pay

Q. When our employees are called for military duty, we pay the difference between what they are being paid by their "military employer" and what they would have been paid if they were still working for us. How should I handle the taxation and reporting of this differential pay?

A. The Heroes Earnings Assistance and Relief Tax Act (see *PAYROLL CURRENTLY*, Issue No. 11, Vol. 16) redefines military differential pay as wages for all payments made after December 31, 2008.

Effective January 1, 2009, any amount paid to an

employee while the employee is performing military service is to be treated as wages subject to federal income tax withholding and reported on Form W-2 in Box 1. Such payments are also subject to social security, Medicare, and federal unemployment taxes if they're made while the employee is on temporary assignment up to 30 days with the state national guard or the armed forces reserve. After 30 days, then social security, Medicare, and federal unemployment taxes don't apply.

Identity theft

Q. We were contacted by someone who said that while he had never worked for us, we reported wages for him for 2006, 2007, and 2008. The IRS brought this to his attention, and told him to contact us to get an official letter stating that he had never worked for us. What steps should we take to verify that this person is the true holder of the social security number (SSN) and that the person who worked for us is not?

A. The person who's claiming that he never worked for your company needs to fill out a Form 14039, *Identity Theft Affidavit*. What that does is give the IRS information about the taxpayer's situation. It says that he believes he was a victim of identity theft and believes it will have an effect on his tax account (which, of course, it will). We also have an IRS Identity Protection Specialized Unit, which you can contact at 1-800-908-4490 (see www.irs.gov/privacy/article/0,,id=186436,00.html).

Social Security Administration

SSA invites APA to help plan wage reporting system redesign

Q. Is it true that the SSA is reexamining its wage reporting system and may require reporting from employers more often than annually? Also, President Obama's budget mentions the possibility of increasing the frequency of wage reporting. What are SSA's intentions in this area?

A. The President's 2010 budget proposes "to restructure the federal wage reporting process to increase the frequency with which wages are reported" to the SSA.

What does that mean? Obviously, increasing the frequency means more than once a year. What will the impact be? I don't have an answer for that right now because we have not gotten any specific directions.

We have had some internal discussions on the impact of an increase in the frequency of wage reporting. In the electronic world, things would be easier than in the paper world. For example, the SSA currently receives 43 million paper W-2s, and it takes us close to nine months to process them. If you go to twice-a-year reporting, that's 18 months for processing, and 18 months do not fit into a 12-month year.

We are working on a related project with the APA and other organizations. Our system, which is about 15 years old, is aging. When it was new in 1993, we were handling 125,000 magnetic tapes and the rest of the W-2s we received were paper. This year, the system that was built for 125,000 magnetic tapes handled 625,000 electronic files. We've begun a multi-year project to rebuild it. In fact, we have already met with a new APA subcommittee to talk about it.

Note: If you would like to join the Government Affairs Task Force Subcommittee on SSA Wage Reporting Redesign or just want to offer suggestions, send an e-mail to APA Senior Manager of Government Relations, Scott Mezistrano, CPP, at smezistrano@americanpayroll.org. We want your input.

New TNEV automated phone service for verifying SSNs

Q. Do you anticipate any changes to the social security number verification process?

A. We're announcing here at the APA Congress that on September 21, we will be changing the process for verifying names and social security numbers (SSNs) over the phone. After September 21, you will no longer speak to a human being when you call. It will be a voice-response system. You're going to have to say the name into the phone, and you're going to have to say the SSN into the phone.

In addition, you will have to register beforehand to use this process. And the registration process is exactly the same as the registration process for the Social Security Number Verification Service. Actually, you register for SSNVS and, by doing that, you get this extra feature, which we call Telephone Number Employee Verification (TNEV).

If you currently do your verification over the phone and you're going to have to register anyhow, you may want to consider doing your verification over the Internet. It is, I think, a little bit easier.

The verification process involves registering and then getting an activation code back. We mail out an activation code to the employer – to the address in the IRS's 941 file. We ask the employer to give it to the employee. The employee has to key in his or her user ID, password, and this activation code. If you're used to doing phone verifications, try and register by the beginning of September, so you get your activation code back in time (go to www.ssa.gov/bsso/bsowelcome.htm for more information).

'No-match' letters

Q. When will the next round of "no-match" letters be sent, and which tax year will they cover?

A. Even after performing a series of routines to try to get the names and numbers to match, we still get about 10 million W-2s where the names and numbers do not match.

One of the things that we've been doing for many years is sending notices out to individuals. We tell an individual that we have received a W-2, but that the name and number did not match. We tell the person that if they want to fix the problem, there are a series of steps that should be taken, and we tell them how to contact the SSA. We, also, at various times, have sent notices to employers, notifying them if they hit a certain threshold of mismatched W-2s.

A few years ago, the Department of Homeland Security (DHS) came to us and said they wanted to add some information to our notices to employers. We agreed to work with the DHS, but then a restraining order was issued against us. The employer no-match letters stopped at that time, and will not resume until the court proceedings have concluded – assuming we are permitted to do so. The SSA continued and continues to this day to send the notices to individuals.

I should add that there are two types of notices that we do send to employers – but in those cases there is no mismatch. When we get W-2s for "young children" under a certain age, we notify the employer involved. In many cases, the W-2 is valid (for example, in the case of a child actor), and the individual has properly received a W-2. The other instance where we send notices to employers is where there are "earnings after death."

Name/SSN mismatches, identity theft, and Form W-2c

Q. We were contacted by someone who said that while he had never worked for us, we reported wages for him for 2006,

2007, and 2008. The IRS brought this to his attention, and told him to contact us to get an official letter stating that he had never worked for us. What steps should we take to verify that this person is the true holder of the SSN and that the person who worked for us is not? If what he says is true, do I file Forms W-2c to back out the wages? Of course, I don't have another name/SSN to which to post the wages, so will I have a discrepancy between my W-2s and 941?

A. First, check your records to see if you ever sent in W-2s under your EIN for that SSN. If you did and our records show the W-2s under your EIN, what you're going to have to do is determine whether you have an employee with that name and number. If you don't, you're going to have to eliminate those wages. Under that name and number on a W-2c, you should zero out the wages so they are not attributed to the person whose number was used in error.

The other thing you should do is file a second W-2c (or multiple W-2cs because you have three different years) with the same name, the amount of wages you've zeroed out, and zeros for the SSN – and this should take care of the mismatch with your 941s. You do not know what the social security number is. Frankly, you're not sure if you have the right name. But if the person who actually did the work ever comes into an SSA office to get it straightened out, then at least we'll have some way of tracking it down.

What this correction process will do is put the earnings information that you have into the Earnings Suspense File, where it will sit. We'll take it off the individual's earnings record.

We are currently working with the IRS, since we see that this is a recurring problem that is not going to go away. We don't have any better solutions now, but we are talking about the problem.

Update on Business Services Online new features

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

A. The registration process is changing a bit. Business Services Online was designed for payroll professionals. However, others are now using it (attorneys, people who need medical evidence). This may be a bit confusing, because these other users have nothing to do with payroll and W-2s and verifying SSNs. But the agency has decided to use the registration process we built for other applications.

Another change coming to the registration screens is that we've broken the process into smaller chunks so you won't have to scroll down the screens as much.

Last year, we changed the way things work if you forget your password. We now ask you to change your password every 90 days. After 90 days, your password goes into a suspended status. When you come back to the site, even if it's beyond the 90 days, you can type in your old password and you will be permitted to create a new one. If you have forgotten your password, you can just answer a series of five questions (questions that you answered when you chose the password originally), and then you will be able to create a new password.

Another development is that the screens will soon look a bit different. They will be cleaner. They'll have tabs at the top where you can select Wage File Upload, W-2 Online, or W-2c Online. And there will be choices so you won't have to scroll down as much.

The future of SSNVS

Q. When will there be a computer-to-computer interface for SSNVS so verifications can be automated electronically instead of having to send files or manually access the SSNVS website?

A. SSNVS permits employers to verify SSNs for wage reporting purposes (not for 1099s, 1040s, mortgages, etc.). Currently, there are two ways of using it. You can input up to 10 SSNs on a screen at a time and get an instant response. Alternatively, you can send a file with up to 250,000 SSNs and get a response the next business day. Using this method, you have to go back into the system to get the response.

We are working on a project that we call the web service, which will allow computer-to-computer communication without human intervention. We're testing out that concept right now with wage reporting. But we're not planning to use it for SSNVS at this time.

SSA's W-2c Online vs. APA's fill-in Form W-2c

Q. What are the differences between the SSA's W-2c Online and the APA's fill-in Form W-2c? When would I use one, and when would I use the other?

A. Several years ago, you could file W-2cs electronically with SSA using the EFW2C format. But if you just had a couple to do, you had to send them in on paper.

The APA, to give them credit here, was ahead of us on this. They came up with a way for you to key information onto their form to create a paper W-2c, so you didn't have to do it by hand. If you didn't have the software to do a W-2c, you could do it at the APA's website.

Since that time, seeing the light, we've come up with a product called W-2c Online. And probably the biggest difference between what APA has and what SSA has now is that when you create a W-2c with us using W-2c Online, you can file that electronically, get a receipt, and print out paper copies for your employees. It's an automated process.

Form W-2c and the problem of an employee with multiple W-2s

Q. Our company has just one employer identification number, but our separate divisions issue their own Forms W-2. We have one employee who worked for all three divisions and got three W-2s, and now one of the divisions has told me it made an error and wants me to correct it. Shall I do it on the basis of only the W-2 issued by that division or by taking into consideration the total of the three W-2s?

A. We give you a choice of what to do with your W-2cs. Because it's all under the same EIN, you can do it either way – correct the amount on the one W-2 with the error or correct the total amount from all three W-2s.

Totalization agreements

Q. One of our employees from Ireland is transferring to one of our offices in the United States on a long-term assignment. Do I withhold social security and Medicare taxes from his pay? Do I need to withhold any Irish social insurance taxes?

A. There are currently totalization agreements in effect with 24 countries around the world, and Ireland is one of these. These are treaties that permit you to pay social security-type taxes to one country or the other, but not to both countries. So in this case you would pay either into the Irish social security system or the U.S. system, depending on the length of the assignment.

The SSA website has lots of information about these agreements (www.socialsecurity.gov/international/index.html).

Using Sr. and Jr. to distinguish employees

Q. We have a few pairs of fathers and sons working for us who have the same name. May I use a suffix of "Jr." or "Sr." to distinguish their paychecks and Forms W-2?

A. Yes, you may. There are spaces to put these kinds of things in the electronic files and on the paper W-2 sent to SSA or provided to the employees.

E-Verify and the SSA

Q. When an alien becomes a citizen, why doesn't the State Department notify the SSA? This would prevent tentative nonconfirmations when we use E-Verify.

A. The reason why the State Department doesn't notify the SSA is because it's no longer their job. It's now the responsibility of USCIS. And they implemented a system about nine months ago whereby the database that holds that information now does communicate with the SSA.

Office of Child Support Enforcement

More states participating in e-IWO program

Q. What is the status of the e-IWO project? How many states and employers are participating? Are you considering expanding it to include medical support orders?

A. We have been working on the e-IWO (electronic income withholding order) project for several years, and we are happy to report that it's up and running, and that it's working very well. Nineteen states (Arizona, California, Colorado, Illinois, Indiana, Massachusetts, Michigan, Nebraska, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Texas, Virginia, Washington, West Virginia) and the District of Columbia will be participating by the end of June, and four more states (Georgia, Maryland, Mississippi, New Jersey) are in development and scheduled to be up by the end of the year.

We have four employers up and running – the U.S. Postal Service, the Department of Defense (which also does the payroll for the Department of Health and Human Services and the Department of Energy), ADP, and Ruby Tuesday. Two more employers – Union Pacific Railroad and Express Professionals – are expected to be up and running by the end of June. We're finding that as we get more employers joining the portal, it's encouraging more states to participate.

The federal office created this portal so that employers and states would have one entity to communicate with. Rather than employers having to go to each individual state to set up an electronic process, you set up the process with the portal and it works for all states that are participating. And the same thing is true for the states, which can work with the portal to access all participating employers.

We've come up with a "no programming" solution for employers. It will allow you to receive either an Excel spreadsheet or a fillable PDF. You just have to have an SFTP connection. But then, of course, you'll still have to enter the information into your system and do some back-end processing. We are always willing to talk to employers and their IT staffs and share information about this program.

We are in the process of developing the record layouts to automate the National Medical Support Notice (NMSN). We're going to put together a work group just like we did when we automated the income withholding order. I can't estimate when it will be up, but we'll keep you posted.

Impact of economic situation on child support enforcement programs

Q. Is the current economic situation affecting the child support enforcement program? How will it affect agencies' outreach to employers?

A. Yes, child support enforcement has been affected by the economic situation. State child support enforcement agencies are seeing record numbers of modification requests, so I'm sure employers are receiving record numbers of modification orders. And we've seen a decrease in the number of new hires reported by employers, and an increase in unemployment insurance cases. Interestingly, states are realizing an increase in collections because of payments from UI, which is a reliable source of income.

State child support enforcement agencies are being forced to lay off staff or reduce their workweeks. So that makes it more difficult for employers to get some of their questions answered.

Last year, we actually had record collections. But that was largely due to the stimulus payments and the fact that we are able to intercept federal tax refunds for past due child support. We actually increased child support collection by almost \$900 million. We'll be very interested to see what the statistics are going to be for this fiscal year.

Withholding from bonuses and other lump sum payments

Q. Our company pays quarterly bonuses to employees, but I don't learn about these bonus payments until just a few days before payday. Which states have laws requiring us to give advance notice on bonuses?

A. The OCSE website has a lump sum matrix that identifies the states that require employers to report a bonus or lump sum payment prior to issuing the payment to the employee. In addition, the standard income withholding order – both the paper and electronic versions – allow employers to notify states electronically that a lump sum or bonus payment is on the way.

We're aware that the bonus-lump sum situation, as it pertains to child support, can present difficulties for employers, and we're convening a work group with employers and states in order to work through some of these issues and improve the reporting process.

For example, Ohio does not have a centralized location for employers to report bonuses. The state requires employers to notify each individual county when a bonus or lump sum payment is coming. We're working with the state to see if we can get them to centralize this process. In addition, there isn't a standard definition of a lump sum or bonus payment across the states.

Bonuses, lump sum payments, and CCPA limits

Q. Some states request that we withhold 100% from an employee's lump sum/bonus while others direct us to use the Consumer Credit Protection Act limits. Should employers always use the CCPA limits when attaching bonus/lump sum payments?

A. No. The limits applicable to lump sum bonus payments are found in state law. In some states, bonuses and lump sum payments may be 100% attachable, while in others, employers are directed to apply CCPA limits.

Medical support and CCPA limits

Q. I recently received a National Medical Support Notice requesting that I add a child to one of my employee's health insurance coverage. The employee is already covered under a

"self and family" plan. Therefore, adding the child would be no additional cost to the employee. When determining the CCPA limit, do I include the cost to the employee to enroll from "self-only" to "self and family," or do I not include any cost in the calculation?

A. This really depends on state law. First, I'd suggest that you check the medical support matrix on our website, which includes information from all the states. If the information you're looking for isn't in the matrix, then you should contact the state (we provide contact information for each state). Be aware that many states are still in the process of implementing the new medical support rules.

Orders to send payments to the custodial parent vs. the SDU

Q. Our company received an income withholding order from an attorney that orders the payment to be sent to the custodial parent. We send our payments electronically to the state disbursement units (SDUs) and would prefer not to have to cut separate checks. How should we handle this?

A. Even though federal and state law require that all payments withheld for child support flow through the SDU – with two exceptions: if the order is pre-1994 or if it's a tribal order – there are still attorneys who are drafting orders that direct payment to the custodial party or, in some cases, to a private collection agency.

We have been working to educate the judicial community that all payments must flow through the SDU when they're withheld for child support. The legislation is very clear; it's not a gray area.

We're doing outreach, letting judges and attorneys know that all payments must flow through the SDU if they are withheld by the employer. We need your help. When you get these orders, please let us know. We want to help resolve this problem.

To answer the question: What should you do? You should contact the attorney who sent the order and ask them to take the order back and have the payment redirected to the SDU. If you don't get a lot of cooperation or you're not having success, please don't hesitate to contact our office.

Requests for verification of employment

Q. Do employers have to respond to requests for Verification of Employment (VOE) even though they report their new hires to the state database of new hires?

A. Yes, you do. If an order is in place and is being enforced, then the information in the new hire database should be sufficient and an income withholding order can be issued to you. But when an order is being established or modified, VOE information is needed. Often, they're looking for health insurance or medical information.

Each state is required to have laws on the books that require employers to respond to VOE requests. We understand that this is difficult for employers because every state has a different form and asks for different information, so we're going to put together a work group to work with states and employers to come up with a standard response to VOE requests.

Multistate employers and new hire reporting

Q. I am registered as a multistate employer to report all of my new hires to one state. We've recently acquired two additional companies. Must I notify the Department of Health and Human Services when my employer acquires or loses a new company?

A. If you notify OCSE and update the information in the multistate employer registry, then you won't be contacted by states questioning whether or not you are reporting new hires. It's not a cumbersome process, and we encourage you to do that.

OCSE provides reports to states on a quarterly basis. And we compare new hire data with quarterly wage data. A discrepancy may be completely innocent if you're a multistate employer and you're reporting to another state. But if you're not updating the information, then it can generate calls from state child support enforcement agencies.

Payment coupons

Q. Many state child support offices send us payment coupons, reminding us about child support payments. We send our payments electronically, so we just throw these away. How can we get the coupons stopped?

A. We have been working with employers to identify the states that are sending payment coupons, and we are contacting these states. We have a technical support team that works with individual states. One of the things they're working on currently is getting states to turn this function off. Often, the employer just needs to contact the state and make a request.

We've also found that some states have a coupon that you can mark and return indicating that you do not need them any more. If that doesn't work, please contact us and we'll be happy to work with the states. We understand that you probably don't want those coupons every month – whether you send e-payments or not.

Misapplied payments

Q. We want to convert to e-payments for child support, but we're worried about losing our money if we make a mistake and send a payment for an employee who didn't work the entire pay period, but whose paycheck for a full period was prepared in advance. Can you guarantee that our money will be returned?

A. No. We can't guarantee that the money will be refunded to you. In rare instances a payment may be misapplied. And this could happen with a paper check as well as an e-payment. States must disburse payments to the custodial party within two days, so their turnaround time is very fast.

Most states use a two-part check before they actually send a payment out the door. They will check both the case ID and the social security number to make sure that the payment is going to the right family. (There are a couple of states that only look at the case ID.)

In some states, when custodial parents sign up for services, they sign an application that says that if they receive a payment in error, then the state will recoup it – e.g., by taking 10% of current support until it's paid in full. In other states, there is no such agreement, so the state has to send a notice to the custodial parent requesting permission to withhold a portion of their child support to pay back the money that was erroneously sent to them. It can be a lengthy process.

We will be happy to work with you and with the state agency if a payment is misapplied to try to get the money refunded to you.

Department of Labor

Correcting a misapplied exemption

Q. What can an employer do if it discovers that it has incorrectly classified some employees as exempt? Is there anything the DOL can do to help the employer resolve the issue and avoid litigation or enforcement activity?

A. If you find a misapplied exemption, you can just fix it and there is no need to notify the Department of Labor. Just make your employee whole. Making someone whole under the law involves going back two years in your records because of the two-year statute of limitations that applies. You can do that on your own.

If you prefer, we'll monitor the process with you and walk you through it and get your people paid properly. But in that situation we have to open up a case file (to monitor our time), and that creates a history on you.

We do a lot of education and outreach. So a third alternative is to run a problem by us either in person or over the phone. We'll be happy to advise you on how to fix it. And you can just do it on your own. It will not trigger a full investigation. We can limit it to your issue and just handle that.

Enforcement trends

Q. There is a perception that Democratic administrations place more emphasis on worker protections than Republican administrations do. Is this a fair assessment, and, if so, what might we expect from the DOL that we haven't seen in recent years?

A. I can only tell you that shortly after January 20th, we were notified that we would be hiring 200 investigators. We're in the process of doing that now, nationwide.

Recently, we've been dealing with cases involving liens and incarceration – things we haven't dealt with in years. But in terms of the way we do our work and the protocols that we follow, it's exactly the same.

For the next two years, with stimulus money in the pipeline, we're going to be doing a lot of targeted work with the construction trades, looking at the issue of prevailing wages under the Davis-Bacon Act. Under the stimulus bill, whether you're the prime contractor or a subcontractor seven tiers down, you have to pay Davis-Bacon wages if \$1 of stimulus money is in that contract.

DAVIS-BACON APPLIES TO CONSTRUCTION PROJECTS FUNDED UNDER ARRA

– The American Recovery and Reinvestment Act of 2009 (ARRA) requires that all laborers and mechanics employed by contractors and subcontractors on projects funded directly by or assisted in whole or in part by and through the federal government pursuant to ARRA shall be paid wages (as determined by the Secretary of Labor) not less than those prevailing on similar projects in the locality. Department of Labor regulations instruct agencies concerning application of the standard Davis-Bacon contract clauses. Federal agencies providing assistance, grants, loans, or guarantees under ARRA must ensure that the standard Davis-Bacon contract clauses are incorporated in any covered contracts in excess of \$2,000 for construction, alteration, or repair, including painting and decorating (see the Summer 2009 issue of the *SSA/IRS Reporter* at www.irs.gov/pub/irs-pdf/p1693.pdf).

Regular rate of pay and the Davis-Bacon Act

Q. When a company has employees working under the Davis-Bacon Act, how does it apply the FLSA standard of regular rate of pay when the DBA says to pay the overtime at the rate (job) at which they are working?

A. If they're working under the DBA the whole time, you should be applying the Davis-Bacon rate the whole time, including overtime.

It's very rare that people work part of a week on a private, commercial job and part of a week on a government job. If

they do split their time, however, then in that case, you do an average for that week.

Retirement buyouts and the regular rate of pay

Q. When doing a buyout for a nonexempt employee who is retiring, do we have to include this lump sum in the calculation of the regular rate of pay?

A. In the case of a retirement incentive, sometimes those payments are made long after the employee is gone, and sometimes they are made in the last workweek.

If a payment is not made within the same workweek or the same pay period (if you have a biweekly or semimonthly pay period), then you don't have to worry about including it in the regular rate of pay.

If it is made in the last workweek, and if it's a discretionary bonus, then it does not have to be considered in the regular rate of pay. But remember that if the payment is tied to production or attendance, then it would have to be included in the regular rate of pay.

Unused sick/vacation lump sum payouts and the regular rate of pay

Q. A company has a policy of paying out unused sick or vacation time each year to its employees. This is a lump-sum payment. Does this payment need to be included in the calculation of the regular rate of pay for nonexempt employees by allocating it back across the pay periods in which it was accrued, and then recalculating overtime?

A. No. These items are considered fringe benefits rather than wages for hours worked, so you don't have to worry about that.

Changing a worker's status from salaried to hourly

Q. Under what circumstances can an employer change a worker's pay status from salaried to hourly? Must the employee agree to the change? Must the employee be notified in advance?

A. I'm assuming that you're not making the change because you have found a problem with the person's exempt status. Aside from that situation, you can change somebody from salaried to hourly (or vice versa) for any reason. There's no law that says you have to pay nonexempt employees on an hourly basis. You can pay nonexempt folks a salary. You just have to monitor it differently – record all hours worked and pay overtime premiums when they work overtime.

The decision is yours. Do they have to agree? No. You're the employer, and it's your business decision. Do they have to be notified in advance? No. However, it's common courtesy and good business practice to do so. Employees you don't notify in advance are more likely to call us.

Paycards and the FLSA

Q. Does the FLSA govern the method of wage payment? Specifically, does the Act govern whether an employer may pay its employees electronically, and, if so, what restrictions are placed on the use of payroll cards?

A. No. The Fair Labor Standards Act doesn't place any restrictions on electronic payments. It doesn't specify a preferred method of payment, electronic or otherwise. In fact, we permit cash pay, which can cause problems when records aren't kept. As long as records are accurate, you can pay by any method you choose as far as we are concerned.

Wage payments caught in the IAT net in September

Q. New rules regarding International ACH Transactions (IATs), designed to stop payments to unauthorized individuals, go into effect in September. We might see an increase in

the number of "false positive" identifications, in which law-abiding employees are misidentified as individuals to whom it is unlawful to make payments. What are an employer's wage payment obligations to employees whose wage payments are caught up in a government inspection?

A. This hasn't come up yet. Generally, I would say that we would treat it like we would anything else that is a stumbling block to paying people. So long as you document that you're trying to do the right thing and pay your employee, we're not going to come down on you or penalize you in any way.

We would probably recommend other payment vehicles, such as a conventional check to ensure that the person gets paid. But the bottom line is that we're going to try and work with you to get the employee paid somehow.

Mandatory days off and loss of FLSA-exempt status

Q. Can an employer require a salaried employee to take a day off without pay without jeopardizing the employee's FLSA-exempt status?

A. The idea of mandatory furloughs is coming up a lot with the economy slowing down. We look at exempt status on a workweek-by-workweek basis. You lose the exemption in the weeks in which a furlough took place or a day off took place. So if the employee works overtime during that week, then you would have to pay overtime, though it's unlikely that they would work overtime because of the day off.

Salary deductions with no loss of FLSA-exempt status

Q. Employers are allowed to take deductions from an exempt employee's salary for unpaid disciplinary suspensions imposed pursuant to a written policy for infractions of workplace conduct rules. What is a "workplace conduct rule"?

A. The definition of a workplace conduct rule is very general. Examples are included in the regulations – a sexual harassment policy, a nondiscrimination policy, an anti-theft policy. If an employee violates a written policy of this type, and if it is general knowledge that violations of the policy will result in deductions from pay, then exempt status is not lost when an employee is disciplined pursuant to the policy.

Illegal aliens and the FLSA

Q. Do the protections provided by the FLSA apply to illegal aliens? If so, how?

A. Yes they do. Illegal aliens working in the U.S. have to be paid just like anyone else. We enforce the FLSA without regard to the worker's immigration status. Regardless of the fact that it may be illegal to employ them, they still need to be paid.

COBRA premium subsidy and plan documents

Q. Must employers amend their plan documents to reflect the fact that they will now pay 65% of the COBRA premium for COBRA-assistance-eligible individuals under ARRA?

A. No, you do not have to amend your plan. The rationale is that the employer is actually not paying that premium, the taxpayer is.

U.S. Citizenship and Immigration Services

Form I-9 version control

Q. Can we be penalized for using the wrong version of Form I-9, *Employment Eligibility Verification*? We got caught in that situation when the implementation of the current form was postponed at the last minute. We had already copied and distributed the form to all of our worksites.

A. We realize that there was an awkward transition between the old form and the new form. And if, for some reason, you used the old form a couple of times, then that's not something we're going to be too concerned with – assuming

you can show that it was a legitimate mistake.

Timeline for completing Form I-9, using E-Verify

Q. What is the earliest opportunity for an employee and employer to complete Form I-9? What is the deadline? What is the earliest opportunity for an employer to use E-Verify? What is the deadline? What if we miss a deadline?

A. The earliest opportunity that an employer has to fill out the Form I-9 is after a job offer has been accepted.

The earliest opportunity that an employer has to use E-Verify is after the Form I-9 has been filled out. The information that goes into E-Verify is based on the information on the Form I-9. So the I-9 has to be the first step.

The deadline for E-Verify is three days. Three days after the employee accepts employment, the information needs to be submitted to E-Verify. If, for some reason, you miss a deadline, just write at the top of the Form I-9 the reason for missing the deadline and go ahead and submit it through E-Verify as soon as possible.

Participation in E-Verify growing fast

Q. I've heard that employer participation in E-Verify is rapidly increasing. Can you tell me what USCIS is doing to keep up with the increased demand and to improve the accuracy and timeliness of the data in the E-Verify system?

A. E-Verify is experiencing explosive growth. Three years ago, there were about 5,000 employers registered to use the system, and today there are over 125,000 employers registered. Employers have run 4.7 million queries through the system.

Most queries – over 96% – come back as employment authorized within seconds. A small percentage come through within 24 hours.

Problems arise with what we call tentative nonconfirmations. A tentative nonconfirmation means that an employee action is required because there's a mismatch in the data on the SSA side or the DHS side. This past year we put in place a system that automatically notifies the employer when an SSA tentative nonconfirmation has been resolved.

We've also instituted new programs for foreign-born and naturalized citizens, groups that received an inordinate number of tentative nonconfirmations in the past (see [PAYROLL CURRENTLY, Issue No. 6, Vol. 17](#)).

Federal contractors and E-Verify queries on existing employees

Q. We're a federal contractor. When E-Verify becomes mandatory for us on September 8, 2009 (see [PAYROLL CURRENTLY, Issue No. 12, Vol. 17](#)), we will have to submit E-Verify queries on all existing employees who work under any federal contract. If an existing employee previously cleared the I-9 process with documents that wouldn't work under today's I-9, will this employee pass an E-Verify screening? For example, an employee may have used an identity or eligibility document that was fine at the time, but is no longer on the list of acceptable documents (see [PAYROLL CURRENTLY, Issue No. 26, Vol. 16](#)). Or an employee may have used an unexpired driver's license that I see has since expired.

A. This regulation requiring federal contractors to use E-Verify was proposed during the previous administration. On January 20th, it was delayed and is under review by the current administration. The clause that is being reviewed is the clause about submitting E-Verify queries on existing employees. We don't know whether or how the regulation will change, and we are waiting to see whether this clause will be in it when it is

eventually implemented.

Federal contractors and duplicate E-Verify queries

Q. We're a federal contractor. After September 8, is it okay if we submit queries on employees who have been previously cleared through E-Verify? If not, can E-Verify provide an electronic file of the employees who have been verified, including the data submitted to E-Verify, the case resolution date, and the case resolution status?

A. We request that you do not submit an E-Verify query on someone who has already been queried. E-Verify can provide you with a management report listing the employees who have already been run through the system. If you're using a designated agent, they also have access to that report.

Form I-9, E-Verify, and prospective employees

Q. If a prospective employee and I complete Form I-9, but then he or she never shows up to start work, do I need to keep the I-9? If I'm using E-Verify at the location at which this person would have worked, do I need to perform an E-Verify query?

A. Because you have already filled out the Form I-9, you are required to keep it and file it. However, you do not need to perform an E-Verify query. The person has "self-terminated," so that's not necessary.

Date of attestation on Form I-9

Q. Section 2 of Form I-9 is the "Employer Review and Verification." It asks for an attestation that "the employee began employment on" a particular date. If the I-9 is completed after the employee accepted the offer, but before the first day of work, what date should be entered?

A. You should enter the date that the employee accepted the offer.

English and Spanish versions of Form I-9

Q. We have worksites where Spanish is the first language of many of the employees. Am I required to offer them both the English and Spanish versions of Form I-9?

A. While you may provide them with the Spanish version of Form I-9 for translation purposes, the only location where the Spanish form is authorized for use is Puerto Rico. The English version of Form I-9 must be used everywhere else. In other words, the form employees should sign and file is the English version.

Selective use of E-Verify and the problem of discrimination

Q. I've heard that if an employer uses E-Verify to validate the work eligibility of some new hires, it must use E-Verify for all new hires, to avoid claims of discrimination. We weren't planning on using E-Verify just yet, but now that there are some states that require it for certain employers, I'm wondering if I have to use it for all new hires or just all new hires in those states.

A. We give employers the option. Over half the states now have laws requiring the use of E-Verify in some circumstances, whether for public entities or for those who do business with the state. And some states, notably Arizona and Mississippi, require all employers to use E-Verify.

You must use E-Verify at all worksites in states that require the use of E-Verify, and you must use it on all new hires so there is no discrimination.

However, if you have worksites in several states and the laws are different in those states, it's up to you to determine whether you want to bring your entire company into the E-Verify system or just use it at those worksites that are affected by state laws on E-Verify. ■