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## IRS Will Conduct 6,000 Random Employment Tax Audits for National Research Program

The IRS will begin an employment tax National Research Program (ET-NRP) component in February 2010 – three months later than originally anticipated. The program was first announced at the APA's Capital Summit last March by John Tuzynski, Chief, Employment Tax Operations, SB/SE (see [PAYROLL CURRENTLY, Issue No. 7, Vol. 17](#), "Federal Agency Speakers Outline a Busy Future for Payroll ..."). *Note:* The NRP is an intensified audit program – a line-by-line examination of tax returns – used to compile statistical data.

The IRS has advised the APA that this first ET-NRP since 1984 will involve audits of 6,000 employers over three years – 2,000 per year. Employers will be randomly selected for auditing; no employers are more or less likely to be selected,

and there is nothing a company can do to increase or decrease its chances of being audited. All records pertaining to employment tax issues – e.g., worker classification, fringe benefits, officers' compensation, and employee expense reimbursement plans – will be subject to review during the examinations. Employers should have all of their records for these items in order.

The purpose of the ET-NRP is to help the IRS develop information on the impact of employment tax noncompliance on the tax gap (i.e., the amount of tax that is not voluntarily and timely reported and paid), gain knowledge of its customer base, and better allocate its resources to focus compliance efforts on the areas of highest noncompliance. ■

## IRS Issues Federal 'High-Low' Per Diem Rates Effective October 1

As part of the Revenue Procedure explaining the rules for determining whether an employee's travel expenses have been adequately substantiated, the IRS has released the optional "high-low" per diem rates (i.e., the sum of the lodging and meal and incidental expenses (M&IE) rates) that may be used instead of the General Services Administration's "actual" per diem rates for travel to locations within the continental U.S. (CONUS; the GSA rates are discussed in [PAYROLL CURRENTLY, Issue No. 17, Vol. 17](#)), the special federal M&IE per diem rates applicable to the transportation industry, and the per diem rate for incidental expenses (see *The Payroll Source*®, starting at p. 3-47). The updated high-low rates apply for travel

undertaken on or after October 1, 2009 (but see discussion of the transition rule below) [Rev. Proc. 2009-47, 9-30-09; [www.americanpayroll.org/members/Forms-Pubs/#perdiem](http://www.americanpayroll.org/members/Forms-Pubs/#perdiem)].

### High-low rates

The "high" rate increases to \$258 (from \$256) for travel to any high-cost locality, while the "low" rate increases to \$163 (from \$158) for travel to any other locality within CONUS. The amount of the high and low rates that is treated as paid for meals increases to \$65 (from \$58) for a high-cost locality and \$52 (from \$45) for any other locality within CONUS.

**High-cost localities.** The following high-cost localities have a federal per diem rate of \$211 or more for all of the

calendar year or the portion of the calendar year specified:

- Phoenix/Scottsdale (1/1 - 5/31) and Sedona (3/1 - 4/30), AZ;
- Monterey, Napa (4/1 - 11/30), San Diego, San Francisco, Santa Barbara, Santa Monica, and South Lake Tahoe (12/1 - 3/31), CA;
- Aspen (12/1 - 4/30), Denver/Aurora, Steamboat Springs (12/1 - 3/31), Telluride (12/1 - 3/31 and 6/1 - 9/30), and Vail (12/1 - 3/31), CO;
- Washington, DC;
- Fort Lauderdale (10/1 - 4/30), Fort Walton Beach/De Funiak Springs (6/1 - 7/31), Key West, Miami (1/1 - 3/31), and Naples (1/1 - 4/30), FL;
- Chicago, IL;
- Bar Harbor (7/1 - 8/31), ME;
- Baltimore (3/1 - 11/30), Cambridge/St. Michaels (6/1 - 8/31), Montgomery and Prince George's Counties, and Ocean City (6/1 - 8/31), MD;
- Boston/Cambridge, Martha's Vineyard (6/1 - 8/31), and Nantucket (6/1 - 9/30), MA;
- Conway (7/1 - 8/31), NH;
- Floral Park/Garden City/Great Neck, Glens Falls (7/1 - 8/31), Lake Placid (7/1 - 8/31), New York City, Saratoga Springs/Schenectady (7/1 - 8/31), and Tarrytown/White Plains/New Rochelle, NY;
- Hershey (6/1 - 8/31), and Philadelphia, PA;
- Jamestown/Middletown/Newport (5/1 - 10/31), RI;
- Park City (1/1 - 3/31), UT;
- Arlington and Fairfax Counties, Alexandria, Fairfax, and Falls Church, VA;
- Seattle, WA; and
- Jackson/Pinedale (7/1 - 8/31), WY.

**Added.** The following localities have been added to the list of high-cost localities: Monterey, CA; Denver/Aurora, CO; Bar Harbor, ME; Conway, NH; Glens Falls and Lake Placid, NY; and Hershey, PA.

**Changed.** The portion of the year for which the following are high-cost localities has been changed: Phoenix/Scottsdale, AZ; Napa and San Diego, CA; Telluride and Vail, CO; Miami and Naples, FL; Baltimore, Cambridge/St. Michaels, and Ocean City, MD; and Jamestown/Middletown/Newport, RI.

**Removed.** The following localities have been removed

from the list of high-cost localities: Crested Butte/Gunnison and Silverthorne/Breckenridge, CO; and Palm Beach, FL.

**Redefined.** The following localities have been redefined: Floral Park/Garden City/Great Neck, NY no longer includes Glen Cove and Roslyn; Tarrytown/White Plains/New Rochelle, NY no longer includes Yonkers.

### Transportation industry rates

The federal M&IE rates for the transportation industry increase to \$59 (from \$52) for any locality of travel within CONUS and \$65 (from \$58) for any locality of travel outside the continental U.S. (OCONUS). These special M&IE rates simplify recordkeeping for employers whose employees routinely travel overnight to many different locations during a single payroll period. To qualify, the transportation must directly involve moving people or goods by airplane, barge, bus, ship, train, or truck, and must regularly require travel away from home on trips among localities with differing M&IE rates.

### Transition rule

Revised actual per diem rates, issued by the GSA, also took effect October 1, 2009. An employer that used the GSA rates for an employee during the first nine months of 2009 may not use the high-low substantiation method for that employee until January 1, 2010. Conversely, an employer that used the high-low substantiation method for an employee during the first nine months of 2009 must continue to use that method for the remainder of calendar year 2009 for that employee (and may continue to use the rates and high-cost localities in effect for the first nine months of 2009 for travel between October 1 and December 31, 2009, if those rates and localities are used consistently during this period for all employees reimbursed using this method).

### Incidental expenses

Instead of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, an employee or self-employed individual may use an amount computed at the rate of \$5 (was \$3) per day for each calendar day (or partial day) he or she is away from home. This amount will be deemed substantiated provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day). ■

## IRS Releases Draft of New Schedule R for Aggregate Form 941 Filers

The IRS has released a draft of new Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*. The form is to be used beginning in 2010 each time an aggregate Form 941 is filed. It is available for review on the APA website at [www.americanpayroll.org/members/Forms-Pubs/#drafts](http://www.americanpayroll.org/members/Forms-Pubs/#drafts).

To file an aggregate Form 941, you must have been approved by the IRS as an agent. To request authorization to act as an agent for an employer, file Form 2678, *Employer/Payer Appointment of Agent*, with the IRS. On Schedule R (Form 941), those employers are called clients.

The purpose of Schedule R is to allocate the aggregate information reported on Form 941 to each client. If an agent has more than 12 clients, continuation sheets must be completed as necessary. Schedule R (Form 941), including any continuation sheets, must be attached to the aggregate Form 941 and filed with the agent's return.

Schedule R (Form 941) has seven columns. For each client the agent must report the following information. The agent must

also report the same information for its employees:

- **Column (a).** Client's employer identification number (EIN),
- **Column (b).** Wages, tips, and other compensation allocated to the listed client EIN from line 2 of Form 941,
- **Column (c).** Total income tax withheld from wages, tips, and other compensation allocated to the listed client EIN from line 3 of Form 941,
- **Column (d).** Total social security and Medicare taxes allocated to the listed client EIN from line 5d of Form 941,
- **Column (e).** Total taxes after adjustments allocated to the listed client EIN from line 8 of Form 941,
- **Column (f).** Advance earned income credit payments allocated to the listed client EIN from line 9 of Form 941, and
- **Column (g).** Total deposits and COBRA payments from line 13 of Form 941, plus any other payments allocated to the listed client EIN.

The column totals must match the related lines on the aggregate Form 941. ■

## Capitol Hill Update

The following are some recent payroll-related legislative developments. All information is current through October 1, 2009.

### Unemployment Compensation Extension Act

H.R. 3548 would amend the IRC to extend the 0.2% FUTA surtax through December 31, 2010. The FUTA tax rate is scheduled to decrease from 6.2% to 6.0% in 2010 because the 0.2% FUTA surtax is set to expire on December 31, 2009 (see *PAYROLL CURRENTLY*, Issue No. 21, Vol. 16, “Emergency Economic Stabilization Legislation Enacted”).

The bill would also amend the Social Security Act (title IV part D) to require an employer to report to the state Directory of New Hires, in addition to other information, the “first day of earnings” – i.e., the date services for remuneration were first performed by a newly hired employee. In addition, the requirement that an employer file new hire reports on a W-4 or equivalent form would be qualified by adding the phrase “to the extent practicable.”

The bill was approved 331-83 by the House of Representatives on September 22. The Senate has not yet voted on it.

### Department of Homeland Security Appropriations Act, 2010

H.R. 2892, as approved by the Senate on July 9, 2009, would make the E-Verify program permanent. Currently, annual votes are required to extend and fund the program. The version of the bill approved by the House on June 24 contains no provision on E-Verify. Differences between the Senate and

House versions of the bill must be worked out before a final vote can be taken. It is unclear whether the E-Verify provision will be included in the version of the bill that emerges from a Senate-House conference committee.

### Recently introduced bills

**Taxpayer Responsibility, Accountability, and Consistency Act.** H.R. 3408 would terminate §530 of the Revenue Act of 1978 and replace it with a new safe harbor provision for employers that misclassify workers as independent contractors, including statutory standards for determining whether an employer had a reasonable basis for not treating an individual as an employee. The bill would also require information reporting for payments of \$600 or more to corporations and increase the penalties for failure to file correct information returns or payee statements. The bill has not been brought up for a vote in either the House or Senate.

**Tax Equity for Meal Replacements and Supplements Act.** H.R. 3406 would amend IRC §105 to treat as “medical care” certain dietary supplements and meal replacement products.

**Tax Relief for Working Caregivers Act.** H.R. 3434 would amend IRC §21(a) to increase from \$15,000 to \$75,000 the taxpayer adjusted gross income amount at which the tax credit for household and dependent care expenses is phased down, allow the credit for a physically or mentally incapacitated parent or grandparent of the taxpayer who is a dependent of the taxpayer, and provide for an inflation adjustment to the maximum dollar limitation for the credit after 2010. ■

## IRS Assesses FedEx \$14 Million for Misclassifying Workers

In addition to filing quarterly and annual reports, public companies must file Form 8-K, *Current Report*, with the Securities and Exchange Commission to announce “material corporate events” that shareholders should know about on a more current basis. In a report filed by FedEx Corporation on September 11, 2009, the company supplemented its financial statements with a note about “legal challenges or changes related to FedEx Ground’s owner-operators.”

Two days before the filing, on September 9, FedEx learned that an IRS audit had concluded that independent

contractors providing the FedEx Home Delivery service had been misclassified and that the IRS proposed assessing employment and withholding taxes and penalties of \$14 million plus interest for calendar year 2002.

The company reported that similar issues are under audit for calendar years 2004 through 2008, but said it continues to believe that its treatment of these workers is appropriate, that it intends to “vigorously contest” the “erroneous conclusions” in the audit, and that it cannot yet project the amount of a potential loss. ■

## IRS Issues COBRA Premium Subsidy Q&As on Change in Eligibility

The IRS has released questions and answers for employees and former employees on a change in employee eligibility status for the new COBRA premium subsidy under the American Recovery and Reinvestment Act of 2009 [[www.irs.gov/newsroom/article/0,,id=212637,00.html](http://www.irs.gov/newsroom/article/0,,id=212637,00.html)].

**Q. I just started a new job that provides group health insurance, so I am no longer eligible for the COBRA subsidy. How do I notify my former employer that I should no longer be receiving the subsidy?**

**A.** If you become eligible for other group health coverage (such as coverage from a new job) or Medicare coverage, you are no longer eligible for the COBRA subsidy. You must notify the health plan that has been providing your COBRA coverage that you are no longer eligible for the subsidy. This notification must be made in writing.

Once you become eligible for other group health coverage

or Medicare, you are no longer eligible for the COBRA premium subsidy, regardless of whether you actually enroll in the other group health coverage or Medicare. Once eligibility for the subsidy ends, if you continue to receive COBRA coverage, you must pay the full COBRA premium without the subsidy, in addition to notifying the health plan.

The U.S. Department of Labor provides a model notice for employers and plans to advise individuals of their right to the subsidized COBRA continuation coverage. The last page of the notice includes the form you should use to notify your plan that you are no longer eligible for the COBRA subsidy (see [www.americanpayroll.org/members/Forms-Pubs/#arra](http://www.americanpayroll.org/members/Forms-Pubs/#arra), “ARRA COBRA Notice, General Notice (full version), p. 13).

**Q. What happens if someone fails to notify their plan that they are eligible for other group health coverage or Medicare?**

A. An individual who fails to notify the health plan providing COBRA coverage and continues to receive the COBRA premium subsidy after they are eligible for other group health coverage or Medicare may be subject to a penalty under IRC §6720C. This penalty is equal to 110% of the subsidy provided on the individual's behalf after they became eligible for the other coverage or Medicare.

**Q. How does a person report the new penalty to the IRS?**

A. Anyone who failed to notify their plan that they are no longer eligible for the COBRA subsidy should self-report

that they are subject to the penalty by calling the IRS toll-free customer help line at 1-800-829-1040. In addition, the individual must notify their plan that they are no longer eligible for the COBRA premium subsidy.

Anyone who suspects that someone may be receiving the subsidy after they become eligible for group coverage or Medicare may report this to the IRS by completing Form 3949 A (*Information Referral*; [www.irs.gov/pub/irs-pdf/f3949a.pdf](http://www.irs.gov/pub/irs-pdf/f3949a.pdf)). The completed form should be printed and mailed to: Internal Revenue Service, Fresno, CA 93888. ■

## SSA Delays Conversion to TNEV Automated Phone Service for Verifying SSNs

At the APA's 2009 Congress, the Social Security Administration (SSA) announced that it would be changing the process for verifying names and social security numbers (SSNs) over the phone (see *PAYROLL CURRENTLY*, Issue No. 13, Vol. 17). The SSA has now delayed the planned elimination of telephone agents from September 21 until the end of October. Effective November 1, you will no longer speak to a human being when you call. It will be a voice-response system. You will say the name and SSN into the phone.

You have to register beforehand to use this process. The registration process is exactly the same as the registration

process for the Social Security Number Verification Service. In fact, the SSA explains that by registering for SSNVs, you get this extra feature, called Telephone Number Employee Verification (TNEV).

The verification process involves registering and then getting an activation code back. The SSA mails out an activation code to the employer – to the address in the IRS's 941 file. The employer is asked to give it to the employee. The employee has to key in his or her user ID, password, and this activation code. Go to [www.socialsecurity.gov/bsowelcome.htm](http://www.socialsecurity.gov/bsowelcome.htm) for more information. ■

## IRS Offers Guidance on PTO Contributions to 401(k) Plans

The IRS has issued guidance on the tax consequences of amending a tax-qualified retirement plan to permit:

- **annual contributions of an employee's unused paid time off (PTO) under the employer's PTO plan.** The amendment relates to a contribution (including a §401(k) contribution) or cash out of the unused PTO, determined as of December 31, the end of the plan year [Rev. Rul. 2009-31, 9-5-09; [www.irs.gov/pub/irs-drop/rr-09-31.pdf](http://www.irs.gov/pub/irs-drop/rr-09-31.pdf)]. This guidance looks at two situations (see 1-2 below).

- **contributions of accumulated and unused PTO at the participant's termination of employment.** The amendment relates to a post-severance contribution or cash out of the accumulated and unused PTO [Rev. Rul. 2009-32, 9-5-09; [www.irs.gov/pub/irs-drop/rr-09-32.pdf](http://www.irs.gov/pub/irs-drop/rr-09-32.pdf)]. This guidance looks at four situations (see 3-6 below).

### Situation 1

**Facts.** Under the Company Z PTO plan, no unused PTO hours remaining as of the close of business on December 31 may be carried over to the following year. Company Z also maintains a profit sharing plan. In December 2008, Company Z amended its profit sharing and PTO plans, effective January 1, 2009, to provide that (1) the dollar equivalent of any unused PTO as of the close of business on December 31 is forfeited and contributed to the profit sharing plan, to the extent the contribution (in combination with prior annual additions) does not exceed the applicable limitation under IRC §415(c), and (2) the dollar equivalent of any remaining PTO is paid to the employee by February 28 of the following year. Under the profit sharing plan, the amounts attributable to PTO are in addition to other contributions under the plan and are treated as nonelective contributions.

As of the close of business on December 31, 2009, the

dollar equivalent of employee A's unused PTO is \$500x. Because of the §415(c) limitation, Company Z contributes \$400x to the profit sharing plan on behalf of A on February 28, 2010, and allocates this amount to A's account under the Z profit sharing plan as of December 31, 2009. Company Z pays A the remaining \$100x in cash on February 28, 2010.

**Analysis.** The amendment to the Z profit sharing plan does not cause it to fail to meet the requirements of §401(a), provided that the nondiscrimination requirements of §401(a)(4) (in combination with other contributions and forfeitures allocated for the year) are met. Because A cannot elect a payment of the dollar equivalent of the unused PTO in lieu of a plan contribution, Company Z's contribution of \$400x to the profit sharing plan is not an elective contribution made pursuant to a cash or deferred election under §401(k)(2)(A) and Reg. §1.401(k)(1)(a)(3)(i). Rather, it is a nonelective employer contribution within the meaning of Reg. §1.401(k)-6.

The amount contributed and allocated for each participant will vary based on the amount of the participant's unused PTO. Therefore, contributions for unused PTO are likely to prevent a plan from satisfying a design-based safe harbor under §401(a)(4). Testing based on the contributions made for individual participants generally will be required.

The contributions must not exceed the limitations of §415(c) (in combination with prior annual additions). Because the contribution of \$400x on behalf of A was allocated to A's account on December 31, 2009, and made February 28, 2010 (before the end of the 30-day period following the deadline for Company Z to file its income tax return), it is subject to the limitations applicable for the 2009 limitation year and is taken into account for §401(a)(4) purposes for the 2009 plan year. Here, the contribution

of \$400x does not cause the plan to exceed the §415(c) limitation.

If the requirements of §401(a)(4) are met, the amount contributed will be includible in A's gross income only when distributed to A. Like any other distribution from Z's profit sharing plan, the distribution of amounts attributable to the dollar equivalent of unused PTO is subject to an additional 10% income tax under §72(t) unless it qualifies for an exception (e.g., made on or after the date the participant attains age 59½ or after the participant separates from service after attaining age 55).

Under the PTO plan, the dollar equivalent of unused PTO is not paid, set apart, or otherwise made available so that A may draw on it either (i) during the 2009 calendar year or (ii) upon conversion in 2009 to a contribution to a qualified plan or cash payment in 2010. Therefore, under the doctrine of constructive receipt and §451, it is not includible in A's gross income in 2009. The \$100x payment is includible in A's gross income in 2010, the taxable year in which it is paid to A.

### Situation 2

**Facts.** Under the Company Y PTO plan, participants may carry over to the following year an amount of unused PTO up to a specified limit. The dollar equivalent of any excess above the carryover limit is paid to the participant by February 28 of the following year. Company Y also maintains a §401(k) plan. In December 2008, Y amended its §401(k) and PTO plans, effective January 1, 2009, to provide that a participant may elect to reduce all or part of the dollar equivalent of any unused PTO that may not be carried over to the following year and have that amount contributed to the §401(k) plan and allocated to the participant's account as of the beginning of the third pay period of the following year (to the extent that applicable limits under §415(c) and §401(a)(30) are not exceeded). Under the §401(k) plan, contributions of the dollar equivalent of PTO are in addition to other contributions under the plan and are treated as elective contributions. The dollar equivalent of any unused PTO that is not contributed to the §401(k) plan is paid to the participant by February 28 of the following year.

Employee B elects to have 60% of the \$450x dollar equivalent of the unused PTO in excess of the carryover limit, or \$270x, contributed to the §401(k) plan, the contribution of which will not cause the plan to exceed the limits under §415(c) and §401(a)(30). On February 1, 2010, Company Y contributes \$270x to the §401(k) plan and allocates it to B's account. Under the terms of the §401(k) plan, this amount is treated as a contribution for the 2010 plan year. Company Y pays the remaining \$180x on February 1, 2010.

**Analysis.** The amendment does not cause the §401(k) plan to fail to meet the requirements of §401(a) and §401(k), provided that the contributions (taking into account other contributions, prior deferrals, and prior annual additions, as applicable) satisfy the nondiscrimination requirements of §401(k) and the applicable limitations of §415(c) and §401(a)(30).

Because B is provided a right to elect either a payment of cash or a plan contribution for the dollar equivalent of unused PTO that may not be carried over to the subsequent year, Company Y's contribution of \$270x to the §401(k) plan and allocation to B's account under the plan is an elective

contribution. Because the contribution is made on February 1, 2010, and is not treated as allocated for 2009, it is taken into consideration for the nondiscrimination requirements of §401(k) and the limitations of §415(c) and §401(a)(30) for 2010.

Here, the allocation of \$270x would not cause the §401(k) plan to exceed the limitations of §415(c) for the 2010 limitation year. Although the dollar equivalent of the unused PTO was made available to B in 2010, pursuant to §402(e)(3), the \$270x is not treated as made available to B if the amount was contributed to the plan as part of a qualified cash or deferred arrangement. If the requirements of §401(k) and §401(a)(30) are met, the contribution will be includible in B's gross income only when distributed to B. Like any other distribution from Y's §401(k) plan, the distribution of amounts attributable to the dollar equivalent of the unused PTO is subject to an additional 10% income tax under §72(t) unless it qualifies for an exception (see above). The \$180x payment is includible in B's gross income in 2010, the taxable year in which it is paid to B.

### Situation 3

**Facts.** Under the Company X PTO plan, if a participant terminates employment, the dollar equivalent of any hours of unused PTO remaining at the termination is paid to the terminated participant within 60 days. Company X also maintains a profit sharing plan. In December 2008, Company X amended its PTO and profit sharing plans, effective January 1, 2009, to provide that the dollar equivalent of any unused PTO at the time of a participant's termination of employment is forfeited under the PTO plan and contributed to the profit sharing plan and allocated to the participant's account as of the first day of the second pay period beginning immediately after the participant's termination of employment (to the extent the contribution, in combination with prior annual additions, does not exceed the applicable §415(c) limitations). Contributions of the dollar equivalent of PTO are in addition to other contributions and are treated as nonelective contributions. Under the PTO plan, the dollar equivalent of any unused PTO that is not contributed to the profit sharing plan is paid to the terminated participant within 60 days after the termination of employment.

Employee C's employment is terminated on October 1, 2009. C has unused PTO with a dollar equivalent of \$300x. A contribution of \$300x to X's profit sharing plan on behalf of C, in combination with prior annual additions, will not cause C's total contributions and annual additions to exceed the §415(c) limitations for 2009. Company X contributes \$300x to the profit sharing plan on October 19, 2009, and allocates this amount to C's account.

**Analysis.** The amendment to the profit sharing plan does not cause it to fail to be qualified, provided that the contributions satisfy the requirements of §401(a)(4) (in combination with other contributions and forfeitures allocated for the year). Because C cannot elect a payment of cash for unused PTO in lieu of a plan contribution, X's contribution of \$300x to the profit sharing plan is not an elective contribution made pursuant to a cash or deferred election, but rather a nonelective employer contribution. Testing based on the contributions made for individual participants generally will be required.

Because the contribution of \$300x was allocated to

C's account as of October 12, 2009, and made on that date (before the end of the 30-day period following the deadline for Company X to file its income tax return), the contribution is subject to the 2009 §415(c) limitations and is taken into account for §401(a)(4) purposes for the 2009 plan year. If the requirements of §401(a)(4) are met, the amount contributed will be included in C's gross income only when it is distributed to C and will be subject to an additional 10% income tax under §72(t) unless it qualifies for an exception.

#### Situation 4

**Facts.** The same as Situation 3, except that C's employment terminates on December 28, 2009, and any payment for unused PTO will be made in 2010 and will be the only payment of compensation that C will receive from Company X in 2010. C has unused PTO with a dollar equivalent of \$300x, which does not exceed the applicable §415(c) limit for 2010. On January 18, 2010, Company X contributes \$150x to the profit sharing plan and allocates it to C's account. This contribution is not treated as a contribution for 2009. Also on January 18, 2010, Company X pays the remaining \$150x to C.

**Analysis.** Company X's contribution to the profit sharing plan is a nonelective employer contribution. Because the contribution is allocated to C's account on January 18, 2010, and made on that date, the contribution is subject to the §415 limitations for the 2010 limitation year and is taken into account for §401(a)(4) purposes for the 2010 plan year.

Here, none of the \$300x exceeds the applicable §415(c)(1)(A) dollar limit for 2010, so the \$150x contribution also does not exceed the limit. However, under §415(c)(1)(B), the \$150x contribution must also not exceed 100% of compensation for the 2010 limitation year. Because the \$150x contribution is a nonelective contribution, it is not taken into account as compensation for §415 purposes. However, because the PTO could have been carried over and used in 2010 had C remained employed, the payment of the remaining \$150x to C on January 18 can be included as §415 compensation for 2010. The allocation of \$150x to C's account will provide an allocation of 100% of compensation and will not exceed the §415(c) limitations for the 2010 limitation year.

If the requirements of §401(a)(4) are met, the amount contributed will be included in C's gross income only when it is distributed to C. Here, the dollar equivalent of unused PTO is not paid, set apart, or otherwise made available so that C may draw on it either (i) during the 2009 calendar year or (ii) upon conversion in 2009 to a contribution to a qualified plan or cash payment in 2010. Therefore, this amount is not includible in C's gross income in 2009. The \$150x payment is includible in C's gross income in 2010, the taxable year in which it is paid to C.

#### Situation 5

**Facts.** In December 2008, Company W amended its §401(k) and PTO plans, effective January 1, 2009, to provide that a participant may elect to reduce all or part of the dollar equivalent of any unused PTO at the time of his or her termination of employment and have that amount contributed to the §401(k) plan. The amount is allocated to the participant's account as of the first day of the second pay period beginning immediately after the participant's termination of employment, to the extent that the contribution (in combination with prior annual additions or

elective deferrals) does not exceed the applicable limitations under §415(c) or §401(a)(30).

Under the §401(k) plan, contributions of the dollar equivalent of PTO are in addition to other contributions and treated as elective contributions. Under the PTO plan, the dollar equivalent of any unused PTO that is not contributed to the §401(k) plan is paid to the employee on the first day of the second pay period beginning immediately after the participant's termination of employment.

Employee D terminates employment on October 1, 2009. D has unused PTO with a dollar equivalent of \$300x. D elects to have 70% of the dollar equivalent of the unused PTO contributed to the §401(k) plan. On October 19, 2009, W contributes \$210x to the §401(k) plan, allocates that amount to D's account, and pays the remaining \$90x to D. The contribution does not exceed the applicable limitations under §401(a)(30) and §415(c).

**Analysis.** The plan amendment does not cause the §401(k) plan to fail to meet the requirements of §401(a) and §401(k), if the contributions (taking into account other contributions, prior deferrals, and prior annual additions) satisfy the nondiscrimination requirements of §401(k) and the applicable limitations of §401(a)(30) and §415(c).

Because D is provided a right to elect either a payment of cash or a plan contribution for the dollar equivalent of unused PTO that may not be carried over to the following year, Company W's contribution of \$210x to the §401(k) plan is an elective contribution. Because it is allocated to D's account as of October 19, 2009, and made on that date, the contribution is subject to the §415 and §401(a)(30) limitations and the nondiscrimination requirements applicable for 2009.

The allocation of \$210x to D's account does not cause the §401(k) plan to exceed the §415(c) limits for 2009. Although the dollar equivalent of the unused PTO was made available to D in 2009, under §402(e)(3) the \$210x is not treated as made available to D because the amount was contributed as part of a qualified cash or deferred arrangement. If the nondiscrimination requirements of §401(k) and the limitations of §401(a)(30) are met, the amount contributed will be included in D's gross income only when it is distributed to D. The distribution of amounts attributable to the dollar equivalent of unused PTO is subject to an additional 10% income tax under §72(t) unless an exception applies. The \$90x payment is includible in D's gross income in 2009, the taxable year in which it is paid to D.

#### Situation 6

**Facts.** The same as Situation 5, except that D's employment terminates on December 28, 2009, and any payment for unused PTO on account of termination will be paid to D in 2010 and will be the only payment of compensation that D will receive from Company W in 2010.

On January 18, 2010, Company W contributes \$210x to the §401(k) plan, allocates that amount to D's account, and pays the remaining \$90x to D.

**Analysis.** Because Company W's contribution is made on January 18, 2010, and is allocated as of that date (before the end of the 30-day period following the deadline for Company W to file its income tax return), the contribution is subject to limitations under §415 and nondiscrimination testing under §401(k)(3)(A)(ii) and Reg. §1.401(k)-2 for 2010.

Because D can elect either a payment of cash or a plan contribution for the dollar equivalent of unused PTO that may not be carried over to the following year, Company W's contribution of \$210x to the §401(k) plan is an elective contribution. As an elective contribution, the \$210x may be treated as compensation for purposes of §415, so that D's

total 2010 compensation for purposes of §415(c) is \$300x (the \$210x elective contribution plus the \$90x payment).

The amount contributed will be included in D's gross income only when it is distributed to D. The \$90x payment is includible in D's gross income in 2010, the taxable year in which it is paid to D. ■

## FMLA Anti-Retaliation Provision Protected Employee Who Requested Leave Before Becoming Eligible

Christopher Reynolds began work for the Inter-Industry Conference on Auto Collision Repair (I-CAR) on August 25, 2005. On August 16, 2006, Reynolds requested leave under the Family and Medical Leave Act (FMLA) to care for his son. The leave would begin in November 2006. When I-CAR terminated Reynolds' employment in response, he sued the company for retaliation in violation of the FMLA.

To be eligible for FMLA leave, an employee must have been employed by the employer for at least 12 months (not necessarily consecutively) and have worked at least 1,250 hours within the previous 12-month period (see *The Payroll Source*®, p. 4-34).

Here, I-CAR said that the FMLA anti-retaliation provision (29 USC §215(a)(3)) did not protect Reynolds because he was not an eligible employee at the time he made his FMLA request. The court disagreed, saying that the FMLA protects

an employee from retaliation when he or she makes a request for leave that will occur when the employee is FMLA-eligible, even if the employee is not eligible at the time the request is made.

The court said that the FMLA (29 USC §2612(e)(a)) protects employers by requiring employees to give 30 days' notice when the need for leave is foreseeable, and it would be illogical to interpret the FMLA to require employees to disclose leave requests that would expose them to retaliation. Additionally, FMLA regulations (29 C.F.R. §825.110) specify that an employee's leave eligibility is determined "as of the date the FMLA leave is to start" – the situation when a currently ineligible employee requests leave to begin at a time when the employee is eligible [*Reynolds v. Inter-Industry Conference on Auto Collision Repair*, No. 08 CV 2115, 2008 U.S. Dist. LEXIS 2807 (ND Ill., 1-13-09)]. ■

## Employer's Piecework Pay Plan Did Not Violate the FLSA

Glaforo Sanchez, Prisciliano Amador, and Gustavo Quiles worked as insulation installers for Guardian Installed Services, Inc. and were paid \$15 an hour. In June 2006, Guardian replaced the hourly pay method of compensating its insulation installers with a commission-based piecework program. Sanchez, Amador, and Quiles sued, saying that the piecework program violated the overtime pay provisions of the Fair Labor Standards Act (FLSA) and would at times reduce their rate of pay below the federal minimum wage.

The Guardian piecework program was a commission-based system using team production footage. The team footage calculation was determined on a per square foot basis, based on the product installed. Pay rates were set per square foot of material installed, and they varied on the job bid and the actual product being installed. An average rate was used to determine how installers were paid for non-work events (e.g., holidays, drive time, shop time, etc.). This average rate was calculated by dividing an installer's total earnings for the previous three months by his total number of hours worked during that time period. If an installer worked more than 40 hours during a given pay week, overtime was calculated by adding the total commission earned to any other earnings for the week (e.g., drive time). This total was then divided by the total number of hours worked that week to calculate the installer's regular rate of pay. To determine the hourly overtime premium, the regular rate was multiplied by .5. The hourly overtime premium was then multiplied by the number of overtime hours worked to provide the total overtime premium.

☞ **WHAT THE LAW SAYS** – An employer does not violate the overtime provisions of the FLSA by employing an employee on a piecework basis if, pursuant to an agreement

or understanding arrived at between the employer and the employee before performance of the work: (1) overtime pay is computed at piece rates at least 1½ times the rates applicable to the same work performed during nonovertime hours; and (2) the employee's average hourly earnings for the workweek are not less than the required minimum, and extra overtime is properly computed and paid on other forms of additional pay required to be included in computing the regular rate (29 USC §207(g)).

### Ruling

Guardian's piecework program did not violate the FLSA. Under the program, the installers' rates of pay never actually fell below the minimum wage. Moreover, installers did not deny receiving overtime pay for the overtime hours they worked; their complaint was that they should have received overtime pay at the rate of \$22.50 per hour, not the rate computed under the piecework program.

The piecework program was implemented based on an understanding or agreement with the employees reached before work under the program was performed. The FLSA does not require that the agreement between employer and employee be in writing. Here, Guardian provided advance notice to Sanchez, Amador, and Quiles on two occasions about the impending change. Before the program was implemented, Guardian also provided its installers with an example explaining the program and method of compensation. Although Sanchez, Amador, and Quiles complained about the program to their branch manager after the program was implemented, they continued to work overtime hours and accept pay under the program [*Amador v. Guardian Installed Svcs., Inc.*, 575 F.Supp. 2d 924 (ND Ill., 9-8-08)]. ■



## STATE AND LOCAL NEWS

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### California

**Workweek and salary reductions for exempt employees OK'd.** The Division of Labor Standards and Enforcement (DLSE) has issued an opinion letter to an employer concluding that a reduction in the workweek for exempt employees and a corresponding reduction in salary, caused by the economic downturn, would not violate the state labor code, wage orders, or federal law [DLSE, Op. Ltr. No. 2009.08.19, 8-19-09].

### District of Columbia

**EFT threshold lowered.** Effective 8-26-09, employers with a withholding tax liability that exceeds \$10,000 in any month must make payments using electronic funds transfer (EFT). Previously, the threshold was \$25,000. The Office of Tax and Revenue (OTR) will give employers a reasonable amount of time to adjust their tax payment process to be in compliance with the new threshold [B. 409, L. 2009; OTR Notice 2009-06, 9-15-09].

### New Jersey

**TDI, FLI, and UI taxable wage base and contribution amounts increased.** For 2010, the temporary disability insurance (TDI) taxable wage base will increase to \$29,700 from the 2009 wage base of \$28,900 (this updates *The Payroll Source*®, p. 7-42). The employee contribution rate remains 0.5% of annual earnings up to the wage base (maximum employee contribution is \$148.50). The new employer contribution rate remains 0.5% of annual earnings up to the wage base.

For 2010, the family leave insurance (FLI) taxable wage base will be \$29,700. The employee contribution rate is 0.12% (currently 0.09%) of annual earnings up to the wage base in addition to the TDI employee contribution rate (maximum employee contribution is \$35.64).

The 2010 unemployment insurance (UI) taxable wage base will increase to \$29,700 from the 2009 wage base of \$28,900 (this updates *The Payroll Source*®, p. 7-23). Effective 1-1-10 through 12-31-10, the employee tax rate remains 0.425% (maximum employee deduction is \$126.23) [Department of Labor and Workforce Development, Notice, Division of Employer Accounts 2010 Rates].

### Virginia

**Tax amnesty program announced.** A tax amnesty program will begin on 10-7-09 and end on 12-5-09. The periods eligible for amnesty (for withholding taxes) are May 2009 and prior. The Department of Taxation (DOT) will waive civil and criminal penalties and one-half of the interest due. Visit [www.getsquareva.com](http://www.getsquareva.com) for more information [DOT, Rulings of the Tax Commissioner No. 09-140, 9-28-09].

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