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## Pension Plan Limits Will Remain the Same in 2010

The IRS has announced the cost-of-living adjustments applicable to dollar limits on benefits and contributions under qualified retirement plans, as well as other items, for tax year 2010. While the cost-of-living index actually decreased from 9-30-08 to 9-30-09, the IRS said that the 2010 limits will be the same as those in effect for 2009 [IR-2009-094, 10-15-09; see [www.americanpayroll.org/members/Forms-Pubs/#guide](http://www.americanpayroll.org/members/Forms-Pubs/#guide)].

Section 415 of the Internal Revenue Code, which provides for dollar limits on benefits and contributions under qualified retirement plans, also requires that the Commissioner annually adjust these limits for cost-of-living changes. The Code also requires various other dollar amounts to be adjusted at the same time and in the same manner as these dollar limits.

- The limitation on the exclusion for elective deferrals under §402(g)(1) (e.g., §401(k) and §403(b) plans) is unchanged at \$16,500.
- The limit on annual additions to defined contribution plans under §415(c)(1)(A) is unchanged at \$49,000.
- For limitation years ending after December 31, 2009, the limit on the annual benefit under a defined benefit plan contained in §415(b)(1)(A) is unchanged at \$195,000.
- The annual compensation limit under §401(a)(17) and §404(l) is unchanged at \$245,000.

- The compensation amount under §408(p)(2)(E) regarding elective deferrals to SIMPLE retirement accounts is unchanged at \$11,500.
- The limitation under §457(e)(15) concerning elective deferrals to deferred compensation plans of state and local governments and tax-exempt organizations (§457(b) plans) is unchanged at \$16,500.
- The limitation under §416(i)(1)(A)(i) concerning the definition of “key employee” in a top-heavy plan is unchanged at \$160,000.
- The limitation under §414(v)(2)(B)(i) for catch-up contributions to §§401(k), 403(b), and 457(b) plans for individuals age 50 or over is unchanged at \$5,500; the limitation under §414(v)(2)(B)(ii) for catch-up contributions to an employer’s SIMPLE plan for individuals age 50 or over remains unchanged at \$2,500.
- The limitation used in the definition of “highly compensated employee” under §414(q)(1)(B) is unchanged at \$110,000.
- The dollar amount under §409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a five-year distribution period is unchanged at \$985,000, while the dollar amount used to determine the

## Payroll Solutions

**Q.** At our company, a chain of hair salons, management wants to charge stylists a fee when they are tipped by customers using credit cards in order to cover the company's cost of processing the credit transactions. Would this fee disqualify the company from using the tip credit under the Fair Labor Standards Act (FLSA)?

**A.** No. Your company can impose a fee for employee tips left on a credit card without disqualifying you from using the tip credit, subject to a number of conditions. Credit card tips must be given to the employee by the next payday, although the credit card company's charge for the use of the card may be deducted from the tip. For administrative simplicity, an employer can use a standard deduction amount where credit card company fees are both over and under that amount and the employer receives no more than the actual credit card fees over a period of time. *Note:* If a customer's credit charge turns out to be uncollectible and it included a tip that your company paid to an employee, your company can recover the tip, but the recovery may not reduce the tips retained by the employee below any tip credit claimed by your company.

Keep in mind that the permissible reduction of credit card tips is limited to the amount charged to your company by a credit card company. Your company cannot use an amount charged to employees to recover its general administrative costs for accepting credit card payments, such as dedicated phone lines or time spent processing credit card transactions.

For more information about the tip credit, see *The Payroll Source*®, pp. 2-37 to 2-39.

lengthening of the five-year distribution period is unchanged at \$195,000.

- The annual compensation limit under §401(a)(17) for eligible participants in certain government plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limit under the plan under §401(a)(17) to be taken into account, is unchanged at \$360,000.

- The compensation amount under §408(k)(2)(C) regarding simplified employee pensions (SEPs) is unchanged at \$550.

- The compensation amount under federal regulation §1.61-21(f)(5)(i), concerning the definition of "control employee" for fringe benefit purposes, is unchanged at \$95,000. The compensation amount under §1.61-21(f)(5)(iii) is unchanged at \$195,000. ■

## IRS Announces Limited Changes in 2010 Amounts for Standard Deduction, Transportation Fringes, and Earned Income Credit

The IRS has released inflation-adjusted tables for 2010 reflecting no changes in many of the items reported because the Consumer Price Index remained flat over the past year. These tax-related amounts are indexed each year under various methods of calculation so that inflation does not erode benefits or push taxpayers into higher tax brackets [Rev. Proc. 2009-50, 10-15-09; see [www.americanpayroll.org/members/Forms-Pubs/#guide](http://www.americanpayroll.org/members/Forms-Pubs/#guide)].

### Personal exemption

The personal exemption amount for 2010 is \$3,650, unchanged from 2009. The phase-out of the personal exemption amount does not apply to taxable years beginning in 2010.

### Standard deduction

The standard deduction amounts for 2010 remain unchanged at \$11,400 for married couples filing jointly or surviving spouses and \$5,700 for single taxpayers and married taxpayers filing separately, while increasing to \$8,400 for heads of households (\$8,350 in 2009). The phase-out of the itemized deduction amounts does not apply to taxable years beginning in 2010.

The extra standard deduction for age and blindness is \$1,100 (unchanged from 2009), which increases to \$1,400 (unchanged) if the taxpayer is single and not a surviving spouse. The standard deduction for an individual who can be claimed as a dependent on another taxpayer's return may not exceed the greater of \$950 (unchanged from 2009) or the sum of \$300 (unchanged) in unearned income and the individual's earned income.

### Qualified transportation fringes

The amounts that may be excluded from gross income for employer-provided "qualified transportation fringe benefits" for 2010 are as follows: \$230 per month for "transportation in a commuter highway vehicle and any transit pass" (unchanged from 2009; per the American Recovery and Reinvestment Act of 2009; see *PAYROLL CURRENTLY*, Issue No. 4, Vol. 17), and \$230

per month for "qualified parking" (unchanged).

### Earned income credit

For 2010, the Earned Income Credit for employees with one qualifying (dependent) child is 34% of the first \$8,970 of earned income, for a maximum of \$3,050 (\$3,043 in 2009). For employees with two qualifying children, the EIC is 40% of the first \$12,590 of earned income, for a maximum of \$5,036 (\$5,028 in 2009). For employees with three or more qualifying children, the EIC is 45% of the first \$12,590 of earned income, for a maximum of \$5,666 (\$5,657 in 2009), and for employees with no qualifying children, the EIC is 7.65% of \$5,980, for a maximum of \$457 (unchanged from 2009). Married employees filing jointly who earn less than \$40,545 in 2010 (\$35,535 for single employees) and who have at least one qualifying child can receive advance payments of their EIC of up to \$1,830 (\$1,826 in 2009) spread out over their pay periods during the year.

The credit begins to phase out in 2010 when a single employee's adjusted gross income (or earned income if that is higher) exceeds \$16,450 and is lost completely when that amount reaches \$35,535 (\$40,363 if the employee has two qualifying children, and \$43,352 if the employee has three or more qualifying children). If the employee is married and filing jointly, the credit begins to phase out at \$21,460 and is lost completely at \$40,545 (\$45,373 if the employee has two qualifying children, and \$48,362 if the employee has three or more qualifying children). For employees with no qualifying children, the credit begins phasing out at \$7,480 (\$12,490 if the employee is married and filing jointly) and is lost completely when the employee's income reaches \$13,460 (\$18,470 if the employee is married and filing jointly).

Taxpayers are ineligible for the EIC in 2010 if their disqualified income (certain investment income) for the year exceeds \$3,100 (unchanged from 2009).

### Medical Savings Accounts

To be eligible to make contributions to a Medical Savings Account (or to have the employer make the contributions), an employee must be covered by a high deductible health plan. For 2010, a high deductible health plan is a plan with an annual deductible of \$2,000-\$3,000 for individual coverage (unchanged from 2009) and \$4,050-\$6,050 for family coverage (\$4,000-\$6,050 in 2009).

Maximum out-of-pocket expenses can be no more than \$4,050 for individual coverage (\$4,000 in 2009) and \$7,400 for family coverage (\$7,350 in 2009).

### Long-term care insurance benefits

If a long-term care insurance contract makes per diem benefit payments, the amount of the payments that is excluded from income in 2010 is capped at \$290 per day (\$280 in 2009), or \$105,850 annually (\$102,200 in 2009).

### Adoption assistance

For 2010, the maximum amount that can be excluded from an employee's gross income for qualified adoption expenses under an employer's adoption assistance program is \$12,170

(\$12,150 in 2009). The maximum amount that can be excluded in connection with the adoption of a child with special needs is \$12,170 (\$12,150 in 2009). The amount excludable from an employee's gross income begins to phase out for taxpayers with adjusted gross income of \$182,520 (\$182,180 in 2009) and is completely phased out for taxpayers with adjusted gross income of \$222,520 (\$222,180 in 2009).

### Pipeline construction industry per diem option

For 2010, an eligible employer may pay certain welders and heavy equipment mechanics up to \$16 per hour for rig-related expenses that will be deemed substantiated under an accountable plan (unchanged from 2009) and up to \$10 per hour for fuel (unchanged), when paid in accordance with Rev. Proc. 2002-41 (2002-23 IRB 1098).

### Foreign earned income exclusion

For 2010, the maximum foreign earned income exclusion amount under IRC §911(b)(2)(D)(i) is \$91,500 (\$91,400 in 2009). The maximum foreign housing cost exclusion amount under IRC §911(c)(2) is \$12,810 (\$12,796 in 2009). ■

## DHS Rescinds Its Employee Name/SSN No-Match Rule

The Department of Homeland Security (DHS) has issued final regulations rescinding its No-Match Rule, relating to procedures that employers may take to take advantage of a safe harbor after receiving No-Match letters [74 F.R. 51447, 10-7-09; <http://edocket.access.gpo.gov/2009/pdf/E9-24200.pdf>]. The final regulations, which are effective November 6, 2009, adopt regulations proposed on August 19, 2009 (see **PAYROLL CURRENTLY**, Issue No. 16, Vol. 17) without change.

### Background

On August 15, 2007, DHS issued a final rule describing the legal obligations of an employer following receipt of a No-Match letter from the Social Security Administration (SSA) or a letter from DHS regarding employment verification forms. The rule also established "safe harbor" procedures for employers receiving No-Match letters (see **PAYROLL CURRENTLY**, Issue No. 17, Vol. 15).

The 2007 rule has never been implemented because of a preliminary injunction issued by the U.S. District Court for the Northern District of California (see **PAYROLL CURRENTLY**, Issue No. 22, Vol. 15). As a result of that litigation, DHS issued a supplemental final rule explaining its position in issuing the rule (see **PAYROLL CURRENTLY**, Issue No. 22, Vol. 16). This rule did not, however, change any regulatory text.

### DHS alters enforcement focus

In the preamble to the new regulations, DHS explains that it has decided to focus its enforcement efforts related to the employment of unauthorized aliens on increased compliance through improved verification. Ongoing initiatives positively influence U.S. employers to exercise proactive immigration compliance, thus restricting the competitive field in which unscrupulous employers operate.

DHS explains that these tools focus more on universal

compliance with the employment eligibility verification requirements of the Immigration and Nationality Act than a safe harbor procedure for a limited number of employers that receive a No-Match letter. A No-Match letter is reactive, whether it is one specifically focused on the employment eligibility issue from the DHS or one pointing to a potential employment eligibility issue from the SSA through social security number record mismatches on tax filings.

Furthermore, DHS has acknowledged that unscrupulous employers would continue to find ways to take advantage of the system, regardless of whether the No-Match rules were in place.

**IMAGE.** DHS continues to provide employer support through the ICE (Immigration and Customs Enforcement) Mutual Agreement Between Government and Employers (IMAGE) program, which is designed to help the business community develop and implement hiring and employment verification best practices.

**E-Verify.** DHS reports that as of September 2009, more than 155,000 employers have signed a memorandum of understanding with DHS to participate in E-Verify, representing more than 500,000 hiring sites; in fiscal year 2009, employers queried E-Verify nearly 8.6 million times.

The Administration and DHS fully support the expansion of E-Verify and have taken steps to encourage its use, including requiring that federal contractors use E-Verify to ensure an employment eligible workforce (see **PAYROLL CURRENTLY**, Issue No. 17, Vol. 17).

**Form I-9.** USCIS recently updated the *Handbook for Employers* (M-274) to provide more comprehensive guidance and instructions for completing Form I-9, *Employment Eligibility Verification* (see [www.americanpayroll.org/members/Forms-Pubs/#non](http://www.americanpayroll.org/members/Forms-Pubs/#non)). ■

## SSA Reminds Electronic W-2 Filers to Use AccuWage

The AccuWage 2009 software and Help Guide and the AccuW2C 2009 software and Help Guide are now available for downloading from the Social Security Administration (SSA) website at [www.socialsecurity.gov/employer/accuwage/index.html](http://www.socialsecurity.gov/employer/accuwage/index.html). In the October 7 edition of its *W-2 News*, the SSA reminds electronic W-2 filers that this free software allows you to check W-2 (*Wage and Tax Statement*) and W-2c (*Corrected Wage*

and *Tax Statement*) reports for correctness before you send them [[www.ssa.gov/employer/w2news/2009\\_03.htm](http://www.ssa.gov/employer/w2news/2009_03.htm)].

**How AccuWage works.** Download the latest version of the AccuWage software to your PC before you prepare your wage reports each year. Then specify the directory where your W2REPORT or W2CREPORT file is located. AccuWage/AccuW2C reads the file and informs you of any errors it detects. Using

AccuWage and AccuW2C greatly reduces submission rejections. The software identifies most of the common format errors in wage submissions. However, note that even if no errors are identified by AccuWage/AccuW2C, your submission could be returned because of other errors.

**Troubleshooting the downloading process.** The Troubleshooting page contains guidance to help you through downloading problems. For 2009, SSA has added a description of the run-time errors '75' and '3051,' as well as a work-around for

administrative problems Windows Vista users may encounter.

**The Help Guide.** The Help Guide contains extensive information on viewing, testing, and correcting errors in the wage report file. For 2009, the SSA has added a shortcut to the AccuWage Help File under: Start > Programs > AccuWage 2009 > AccuWage 2009 Help. A shortcut has also been added to the AccuW2C Help File under: Start > Programs > AccuW2C 2009 > AccuW2C 2009 Help. ■

## State Unemployment Insurance Taxable Wage Bases for 2010

Many states have released their state unemployment insurance (SUI) taxable wage bases for 2010. Due to the downturn in the economy, UI rates in many states have spiked. With more people applying for benefits, UI trust funds in many states have been drained. To combat this, some states have passed legislation to increase their taxable wage base amounts. Some states have passed legislation tying the increase in the UI taxable wage base to the balance in the state UI trust fund. However, not all states have raised their wage base amounts for next year. For a list of the state wage bases, check the APA's website at [www.americanpayroll.org/government/government-resources](http://www.americanpayroll.org/government/government-resources).

Following the Federal Unemployment Tax Act (FUTA) scheme, state unemployment contributions (taxes) are determined by applying a certain percentage to the taxable wages paid by the employer (see *The Payroll Source*®, p. 7-22). FUTA requires that

each state's taxable wage base must at least equal the FUTA taxable wage base of \$7,000 per employee, and most states have wage bases that exceed the required amount.

The states use various formulas for determining the taxable wage base, with many tying theirs by law to the FUTA wage base and others using a percentage of the state's average annual wage.

The types of payments included as taxable wages by the states are generally those considered taxable wages for FUTA purposes (wages, salary, bonuses, commissions, noncash payments). But several states differ from the FUTA approach when it comes to sick or disability pay, cafeteria plan benefits, tips, and other payments. Employers must check the state laws and rules in the states where they have employees to determine whether the payments made to them are taxable wages.

For more information on SUI wage bases and tax rates, see *APA's Guide to State Payroll Laws*, Table 8.2. ■

## IRS Launches New Retirement Plan Navigator

The IRS has created a new web-based tool to help small and mid-sized businesses determine which tax-favored pension plan best suits their needs and how to keep their plans in compliance. The IRS Retirement Plan Navigator, at [www.retirementplans.irs.gov](http://www.retirementplans.irs.gov), focuses on three areas: choosing a plan, maintaining a plan, and correcting a plan. It will be kept up-to-date as pension laws and regulations change [IR-2009-091, 10-13-09; [www.irs.gov/newsroom/article/0,,id=214238,00.html](http://www.irs.gov/newsroom/article/0,,id=214238,00.html)].

**Choosing a plan.** The navigator does not suggest which plan may be best for a specific employer; it lays out options to allow the employer to choose a plan that best fits its situation.

For example, it includes a Plan Comparison Table – a side-by-side comparison of pension plans and their requirements.

**Maintaining a plan.** The navigator provides a checklist and suggested resources for maintaining compliance. It includes links to retirement plan information on [www.irs.gov](http://www.irs.gov) and other agency websites, publications, and other resources.

**Correcting a plan.** The IRS recognizes that many mistakes can be made unintentionally, and that many errors can be corrected without notifying the agency. The navigator offers suggested options to employers seeking to correct errors and bring their plans back into compliance. ■

## No Major Changes in Electronic Filing Specifications for Form 8027 for Tax Year 2009

The IRS has announced that there are no major changes to Publication 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips Electronically*, for tax year 2009 [Rev. Proc. 2009-46, 2009-42 IRB 507; [www.irs.gov/irb/2009-42\\_IRB/ar08.html](http://www.irs.gov/irb/2009-42_IRB/ar08.html)]. Prior guidance is superseded by the updated specifications, which are effective for Forms 8027 due March 1, 2010.

Large food or beverage establishments (more than 10 employees) where tipping is customary must file Form 8027 to determine if tips have been underreported and must be allocated. A separate Form 8027 must be filed for each establishment owned by the restaurant, and if 250 or more forms must be filed, they must be filed electronically (see *The Payroll Source*® p. 8-110). ■

## IRS Corrects Electronic Filing Requirements for Forms 1098, 1099, 3921, 3922, 5498, 8935, and W-2G

The IRS has published corrections and clarifications to the *Specifications for Filing Forms 1098, 1099, 3921, 3922, 5498, 8935, and W-2G, Electronically* for tax year 2009 information returns filed beginning 1-1-10 (Pub. 1220, originally released as Rev. Proc. 2009-30; see *PAYROLL CURRENTLY, Issue No. 14, Vol. 17*) [Ann. 2009-70, 10-13-09; [www.irs.gov/irb/2009-41\\_IRB/](http://www.irs.gov/irb/2009-41_IRB/)

[ar14.html](http://www.irs.gov/irb/2009-41_IRB/ar14.html)].

- In Part A, Sec. 8, Corrected Returns, there is a change to the two-step correction process. Item (d) incorrect payee address, under Error Type 2, should be deleted. Only items (a) No payee TIN (SSN, EIN, ITIN, QI-EIN), (b) Incorrect payee TIN, (c) Incorrect payee name, and (e) Wrong type of return indicator,

require two transactions to properly correct the information.

In addition, Sec. 2, Nature of Changes-Current Year (Tax Year 2009) .01 a. General (3) states changes in correction procedure are to include incorrect TIN, payee name and/or address requires a two-step correction. It should read incorrect TIN or payee name requires a two-step correction.

- In the Payee 'B' Record, two new Payment Amount Fields, F and G, have been added in anticipation of expanded reporting requirements on certain information returns. Currently, there are no corresponding Amount Codes in the Payer 'A' Record. Filers must allow for these amount fields in their payee 'B' Records and like any unused amount fields they must be

## IRS Offers Guidance on Rollovers to Roth IRAs

The IRS has issued guidance describing the federal income tax consequences of rolling over an eligible rollover distribution from an employer plan (i.e., §401(k) plan, §403(b) annuity, §457(b) plan) to a Roth IRA (described in IRC §408A) [Notice 2009-75, 9-8-09; [www.irs.gov/pub/irs-drop/n-09-75.pdf](http://www.irs.gov/pub/irs-drop/n-09-75.pdf)].

### Background

A Roth IRA is a type of IRA under which contributions are not deductible and qualified distributions are excludable from gross income. A designated Roth contribution is an elective deferral that has been designated by an employee as not excludable from the employee's gross income. Designated Roth contributions made to a plan must be maintained in a separate account (a designated Roth account).

Effective in 2008, distributions from qualified retirement plans, tax-sheltered annuities, and governmental 457 plans can be rolled over to a Roth IRA and treated as a Roth IRA conversion (see the Pension Protection Act of 2006; **PAYROLL CURRENTLY, Issue No. 17, Vol. 14**).

Effective for taxable years beginning after December 31, 2009, the income limits on conversions of traditional IRAs to Roth IRAs have been eliminated (see the Tax Increase Prevention and Reconciliation Act of 2004; **PAYROLL CURRENTLY, Issue No. 11, Vol. 14**). Thus, taxpayers may make such conversions without regard to their adjusted gross income (AGI). In addition, married taxpayers filing a separate return may convert amounts in a traditional IRA into a Roth IRA.

### Amount included in gross income

**Rollover of distributions not from a designated Roth account.** If an eligible rollover distribution from an eligible employer plan is rolled over to a Roth IRA and the distribution is not made from a designated Roth account, then the amount that would be includable in gross income were it not part of a qualified rollover contribution is included in the distributee's gross income for the year of the distribution. For this purpose, the amount included in gross income is equal to the amount rolled over, reduced by the amount of any after-tax contributions included in the amount rolled over – in the same manner as if the distribution had been rolled over to a non-Roth IRA that was the participant's only non-Roth IRA and

zero filled.

In addition, in Part C, Sec. 7, .01 the last two sentences should read: 'In the "B" Record, the filer **must** allow for all **sixteen** Payment Amount Fields. **For those fields not used, enter "0s" (zeros).**' These statements also apply to the End of Payer 'C' Record and the State Totals 'K' Record.

- For Form 5498, Payee 'B' Record, Special Data Entries, positions 663-722, the Note about delayed contributions for U.S. Armed Forces should have been deleted. Form 5498 now has specific fields and codes for many types of reporting for Armed Forces personnel. The Special Data Entry field can still be used for any reporting not covered in the new reporting fields. ■

that non-Roth IRA had then been immediately converted to a Roth IRA.

**Rollover of distributions from a designated Roth account.** If an eligible rollover distribution made from a designated Roth account in an eligible employer plan is rolled over to a Roth IRA, the amount rolled over is not includable in the distributee's gross income, whether or not the distribution is a qualified distribution from the designated Roth account.

### Modified AGI limits and joint filing requirements before and after January 1, 2010

**Distributions not made from a designated Roth account.** Except for a distribution from a designated Roth account, an eligible rollover distribution made before January 1, 2010, from an eligible employer plan may not be rolled over to a Roth IRA unless, for the year of the distribution, the distributee's modified AGI does not exceed \$100,000 and, in the case of a married distributee, the distributee files a joint federal tax return with his or her spouse. The \$100,000 limit and the requirement that a married distributee file a joint return do not apply to distributions made on or after January 1, 2010.

If an eligible rollover distribution made before 2010 is ineligible to be rolled over to a Roth IRA either because the distributee's modified AGI exceeds \$100,000 or because a married distributee does not file a joint return, the distribution can be rolled over into a non-Roth IRA and then the non-Roth IRA can be converted, on or after January 1, 2010, into a Roth IRA.

**Distributions made from a designated Roth account.** There are no restrictions based on the modified AGI limitations and joint filing requirements that apply to a rollover of an eligible rollover distribution made from a designated Roth account under an eligible employer plan to a Roth IRA.

### Related safe harbor explanations

Related guidance contains two safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan. The first safe harbor explanation applies to a distribution not from a designated Roth account. The second safe harbor explanation applies to a distribution from a designated Roth account [Notice 2009-68, 9-5-09; [www.irs.gov/pub/irs-drop/n-09-68.pdf](http://www.irs.gov/pub/irs-drop/n-09-68.pdf)]. ■

## Employer Did Not Have Reasonable Cause for Not Paying Employment Taxes Timely

In 2003, Janis Graves, president of Benton Workshop, Inc., sustained a head injury that eventually forced her to stop performing most of her duties, including preparing and filing

Forms 941 and making the company's payroll tax deposits. After Graves' injury, the company continued operations but did not make its payroll tax deposits on the proper schedule

and did not file Form 941 timely for four quarters. When the company became aware of the problem late in 2004, it hired a CPA to handle these matters.

The company appealed to a U.S. District Court for abatement of penalties imposed by the IRS for failure to timely pay and deposit employment taxes. The court said the company was not entitled to abatement because it did not show “reasonable cause” for its actions [*Benton Workshop, Inc. v. U.S.*, No. 4:08CV00339-WRW, 2009 U.S. Dist. LEXIS 74521, (ED Ark., 8-21-09)].

☞ **WHAT THE LAW SAYS** – Under IRC §6651(a)(1) (file), IRC §6651(a)(2) (pay), and IRC §6656(a) (deposit), additions to tax may be excused if the failure to perform the required action was the result of “reasonable cause” and not willful neglect. To demonstrate reasonable cause, a taxpayer must show that it exercised “ordinary business care and prudence” but was nonetheless unable to file the return (or pay or deposit the taxes) within the prescribed time.

#### **Ruling**

Benton Workshop’s failures were not the result of willful

neglect, said the court. The company attempted to comply with its tax obligations because it filed the required forms and paid its tax liability, although it did not follow the proper schedule.

Graves’ impairment was not reasonable cause for the company’s failure to timely deposit employment taxes and file Forms 941. The company took steps to continue to make its payroll and pay creditors but did not make arrangements to ensure that the company’s employment tax filings and payments would continue to be properly made.

A 2005 notice from the IRS indicating that Benton Workshop was a monthly tax depositor did not provide the company with reasonable cause either. The notice cautioned the company to verify the information against its quarterly tax records and stated that the company was responsible for following the proper deposit schedule. Benton Workshop had been a semiweekly depositor in the past and should have continued as a semiweekly depositor. In light of the changes brought about by Graves’ injury, the company should have verified its deposit schedule in the exercise of ordinary business care. ■

## **Motor Carrier Exemption Applied to Shuttle Bus Drivers Carrying Cruise Ship Passengers**

American Coach Lines of Miami, Inc. (ACLM) operated passenger buses. Most of the company’s revenue came from a contract with Royal Caribbean Cruise Lines to provide shuttle service for cruise ship passengers between airports in Miami and Fort Lauderdale and local hotels and cruise ship ports. Under the contract, ACLM was paid directly by Royal Caribbean, not the passengers. Previously, ACLM had similar informal agreements with other cruise lines.

In addition to cruise ship service, ACLM provided other in-state and out-of-state bus transportation. Between 2004 and 2007, ACLM drivers made at least 148 out-of-state trips.

When ACLM drivers sued for unpaid overtime under the Fair Labor Standards Act (FLSA), a U.S. District Court said they were covered by the “motor carrier exemption to the overtime requirements.” The Eleventh Circuit Court of Appeals agreed [*Walters v. American Coach Lines of Miami, Inc.*, 575 F.3d 1221 (11th CA, 7-23-09)].

#### **Motor carrier exemption**

The FLSA exempts from its overtime pay requirements any employee over whom the Secretary of Transportation “has power to establish qualifications and maximum hours of service” under the Motor Carrier Act (29 USC §213(b)(1)). Two conditions must be met before this motor carrier exemption applies: (1) the employer must be either a “motor carrier” or a “motor private carrier” subject to the jurisdiction of the Secretary of Transportation and (2) the employee must be engaged in activities that affect the safe operation of motor vehicles transporting passengers or property in interstate commerce.

#### **Secretary of Transportation’s jurisdiction**

ACLM was subject to the jurisdiction of the Secretary of Transportation. It was licensed by the U.S. Department of Transportation (DOT), was authorized to operate as an interstate motor carrier, and had been subject to audits by the DOT. The company held itself out to the general public as an interstate motor carrier.

#### **Interstate commerce**

*Not de minimis.* The court said that ACLM’s interstate business was not de minimis because although the number of

trips made by drivers that cross state lines was small (about 1%), more than 4% of the company’s revenue came from those trips.

*Part of a practical continuity of movement.* The court explained that ACLM’s shuttle trips between airports and seaports, although occurring intrastate, were part of interstate commerce because they were part of a “practical continuity of movement” of the cruise ships and their passengers. Cruise ship passengers saw ACLM’s shuttles as part of a continuous stream of interstate travel that comprised their cruise vacation because the shuttle ride was either included in their cruise vacation package or billed to them by the cruise line.

*Incidental-to-air exemption and economic vs. safety regulations.* The drivers argued that even if the airport-to-seaport routes were part of interstate commerce, the motor carrier exemption did not apply because of the “incidental-to-air” exemption in U.S. transportation law, which provides that the Secretary of Transportation does not have jurisdiction over “transportation of passengers by motor vehicle incidental to transportation by aircraft” (49 USC §13506(a)(8)(A)). Under DOT regulations, the airport-to-seaport drives by ACLM drivers were incidental because they occurred immediately prior or subsequent to air travel and within a 25-mile radius of the airport. However, DOT regulations define “exempt motor carriers” as those exempt from economic regulation but still subject to safety regulations, such as maximum hours laws. Accordingly, the “incident-to-air” exemption did not eliminate the Secretary of Transportation’s authority to regulate maximum hours under the FLSA.

*Part of a through-ticketing arrangement.* Finally, the drivers argued that the airport-to-seaport trips could not be considered interstate commerce unless they were part of a “through-ticketing” arrangement. The court said that even if a through-ticketing arrangement was necessary, the arrangement existed during the period in question. Since September 2006, ACLM had a formal agreement with Royal Caribbean. Before that, the company had similar informal arrangements with other cruise lines. ■

## Call Center Employees Paid a Flat Rate Were FLSA-Exempt Commission Employees

A U.S. District Court has ruled that employees paid a flat rate for each sale they made by telephone were covered by the “retail or service establishment” exemption of the Fair Labor Standards Act (FLSA) because the payments were commissions [*Parker v. Nutrisystem, Inc.*, No. 08-1508, 2009 U.S. Dist. LEXIS 66597 (ED Pa., 7-30-09)].

### Background

Nutrisystem sells prepackaged meals for weight loss and weight management. The company’s principal products are 28-day meal plans. Sales associates at the company’s call center in Pennsylvania handle incoming calls from potential customers 24 hours a day and make outgoing calls to prospective customers to sell the meal plans.

Sales associates are compensated based on either an hourly rate of pay or a flat-rate per sale, whichever is greater. The hourly rate is \$10 per hour for the first 40 hours in a workweek, and \$15 per hour for hours worked over 40 in a workweek. Under the flat-rate method of compensation, sales associates receive \$18 for each 28-day meal plan sold on an incoming call during daytime hours, \$25 for each plan sold on an incoming call during evening or weekend hours, and \$40 for a plan sold on an outgoing call or during overnight hours. Sales associates paid under the flat-rate method sued to recover overtime pay for hours worked in excess of 40 in a workweek.

☞ **WHAT THE LAW SAYS** – In order to qualify for the retail or service establishment exemption (1) the employee must be employed by a “retail or service establishment”; (2) the employee’s regular rate of pay must exceed 1½ times the minimum wage; and (3) more than half of the employee’s total earnings in a representative period must be commissions on the sale of goods or services (29 USC §207(i)).

Here, the parties agreed that the Nutrisystem call center was a retail establishment and that the regular rate of pay of

sales associates exceeded 1½ times the minimum wage. The question for the court was whether the flat-rate payments were commissions.

### Ruling: commissions

The court said the sales associates were paid on a commission basis. The FLSA does not define “commission,” but a commission generally applies to persons involved with sales. A commission is usually based on a percentage of sales, but this does not mean that a flat rate payment can never be a commission. In order to be considered a commission, a flat-rate payment must be somewhat proportional to the prices paid by customers.

The fact that the associates worked in sales indicated that their payments were commissions. Unlike piecework payment arrangements (which give employees an incentive to work faster but are not FLSA-exempt), a sales employee’s commissions depend on the preferences of customers and fluctuate from period to period, which was the case here.

The flat-rate payments were sufficiently proportional to the products sold to qualify as commissions. There were only minor differences in each of Nutrisystem’s 28-day meal plans, so there was no disparity between the price of the product and the payment to the sales associate for selling a specific meal plan. And while a customer could purchase Nutrisystem meals for more than one month, there was no evidence of the percentage of customers continuing with a meal plan beyond four weeks.

Finally, the fact that Nutrisystem paid different commission rates based on the time of day or week in which a sale was made did not matter. The company was entitled to offer higher commissions for sales completed in the evening or on weekends to maintain its 24-hour availability to customers and encourage sales employees to work less desirable shifts. ■

## Supreme Court Denies Review of Case Involving FMLA Hours-of-Service Eligibility Threshold

The U.S. Supreme Court has refused to hear the appeal of a case involving the Family and Medical Leave Act (FMLA) hours-of-service eligibility test [*Pirant v. U.S. Postal Svc.*, No. 08-1100 (U.S. Sup. Ct., 10-5-09)].

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

Antoinette Pirant did not contest the accuracy of U.S. Postal Service (USPS) payroll records, which showed that she worked only 1,248.8 hours in the 12 months preceding her absence from work. The Seventh Circuit Court of Appeals ruled that the USPS did not violate the FMLA by terminating Pirant’s employment because she was not eligible for leave (see *PAYROLL CURRENTLY*, Issue No. 23, Vol. 16).

**Wrongful suspension.** Pirant claimed that she was wrongfully suspended for two hours before the end of one of her shifts. The court explained that the two hours did not count in determining her FMLA eligibility because she had

not timely pursued her right to challenge the suspension and have the lost hours restored. She was advised that she could file a formal grievance but failed to do so until well after the deadline had passed. Moreover, she did not object when her grievance was dismissed for being untimely.

**Donning and doffing.** Pirant also claimed that the three to five minutes she spent each workday putting on and removing gloves, work shoes, and a uniform shirt, should also count toward her FMLA eligibility. The FMLA provides that the legal standards of the Fair Labor Standards Act (FLSA) apply in determining whether an employee meets the hours-of-service requirement (29 USC §2611(2)(C)).

The court said that Pirant’s work clothing was not “extensive and unique protective equipment,” and that donning and doffing it was analogous to changing clothes “under normal conditions,” which is merely preliminary and postliminary activity that is not compensable under the FLSA. Accordingly, Pirant could not include this time in her hours-of-service total for purposes of the FMLA. ■



## STATE AND LOCAL NEWS

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### Minimum wage indexed for inflation on January 1 by several states and cities

There are nine states and two cities that adjust their hourly minimum wage rate every January 1 for inflation. However, most have recently announced that the minimum wage will not change in 2010 due to a decline in the Consumer Price Index (this updates *The Payroll Source*®, p. 2-68). These states are: Arizona (\$7.25), Florida (\$7.25), Missouri (\$7.25), Montana (\$7.25), Ohio (\$7.30; \$7.25 if annual gross receipts are \$267,000 or less), Oregon (\$8.40), Vermont (\$8.06), Washington (\$8.55), and San Francisco, California (\$9.79). Colorado is holding a hearing on 11-6-09 to consider a proposed decrease in the 2010 minimum wage to \$7.24 an hour from \$7.28 an hour. Santa Fe, New Mexico, has not yet announced its minimum wage for 2010.

### Massachusetts

**UI online reporting mandated.** Effective with the fourth quarter of 2009, employers must file quarterly wage and unemployment insurance (UI) tax reports through QUEST (Quality Unemployment System Transformation), a new web-based program being implemented by the Department of Unemployment Assistance (DUA). Also, UI and unemployment health insurance tax filings will be able to be completed in one process [DUA, DUA QUEST Frequently Asked Questions].

### Minnesota

**Withholding computer formula table issued.** The Department of Revenue (DOR) has issued the 2010 withholding computer formula table, effective for wages paid on or after 1-1-10, at [www.taxes.state.mn.us/taxes/withholding/instructions/formula\\_10.pdf](http://www.taxes.state.mn.us/taxes/withholding/instructions/formula_10.pdf). The 2010 wage-bracket withholding tables and instruction booklet for employers have not yet been issued.

### Nebraska

**UI mandatory electronic reporting and payment threshold lowered.** Effective for tax years beginning on or after 1-1-10, an employer that has an annual payroll of \$100,000 or more (currently \$500,000 or more) for either of the two preceding calendar years will be required to file quarterly unemployment insurance (UI) wage reports and pay taxes by an electronic method approved by the Commissioner of Labor, unless the employer can establish that this would cause a hardship (this updates *The Payroll Source*®, p. 7-36). The Workforce Development Department offers UI Connect at <https://uiconnect.ne.gov/uiconnect/center.cfm> [L.B. 631, L. 2009].

### Rhode Island

**EFT mandated.** Effective 1-1-10, employers with 10 or more employees must make withholding payments by electronic funds transfer (EFT) or other electronic means as determined by the Division of Taxation (DOT). An employer that fails to do so will be subject to a penalty of 5% of the amount due or \$500, whichever is less, unless it is shown that such failure is due to reasonable cause and not willful neglect. The DOT is authorized to waive the electronic filing requirement for employers if it will cause undue hardship [H.B. 5983, L. 2009; DOT Notice, *E-Pay Mandate*, at [www.tax.state.ri.us/notice/efmand/index.php](http://www.tax.state.ri.us/notice/efmand/index.php)].

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