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Update on SSA 'No-Match' Letters for Tax Year 2009

The APA has been advised that the Social Security Administration (SSA) is awaiting a final "Commissioner Determination" on whether "no-match" letters will be sent for tax year 2009. At this time, the SSA has stopped mailing both

EDCOR and employer DECOR letters (see below).

'No-match' letters

As part of the annual wage reporting process, the SSA attempts to match the names and social security numbers

(SSNs) on Forms W-2 (*Wage and Tax Statement*) that are submitted by employers against the file of all issued SSNs. A Form W-2 that contains a name/SSN combination that can be matched to SSA records is posted to the Master Earnings File; when a name/SSN combination cannot be matched to SSA's records, the wage information on the Form W-2 is posted to the Earnings Suspense File, the repository of unmatched items [SSA Office of the Inspector General, *Effectiveness of Educational Correspondence to Employers*; www.ssa.gov/oig/ADOBEPDF/auditxt/A-03-07-17105.html].

EDCOR letters. To resolve name/SSN combinations that cannot be matched, the SSA began sending EDCOR (employer education correspondence) letters to employers in 1994 ("no-match letters"). The EDCOR letter explains to employers that some of the name/SSN combinations reported do not agree with SSA's records and asks employers to submit a Form W-2c (*Corrected Wage and Tax Statement*) for each SSN listed on the letter. In addition, it explains that some of the name/SSN no-matches may be the result of common mistakes (e.g., typographical error) or the failure of an employee to report a name change to the SSA. Absent a hold from the SSA Commissioner or a court injunction (see below), the SSA mails EDCOR letters to employers beginning in February of each year, generally pertaining to W-2s filed in the second-previous tax year.

EDCOR letters for mailing in tax year 2006 were to include a Department of Homeland Security (DHS) insert that would have required employers to take timely action to resolve no-matches associated with the SSNs listed in EDCOR letters to avoid liability under immigration law pursuant to a new DHS rule (see www.americanpayroll.org/members/Forms-Pubs/#non). However, before the SSA began mailing these letters, a lawsuit was filed and a court order issued blocking implementation of the DHS rule and by extension the mailing of the SSA letters with their DHS inserts (see [PAYROLL](#)

[CURRENTLY](#), Issue No. 19, Vol. 15).

The DHS rule, which was never implemented, was rescinded in October 2009 (see [PAYROLL CURRENTLY](#), Issue No. 21, Vol. 17), and the lawsuit was dismissed shortly thereafter (*American Federation of Labor v. Chertoff*, No. C 07-04472 CRB, ND Cal., order of dismissal signed 11-18-09). Meanwhile, while the lawsuit was pending, no EDCOR letters were sent in tax years 2006, 2007, or 2008.

DECOR letters. The SSA sends DECOR (decentralized correspondence) letters to employees whose earnings cannot be credited to its records because the reported name/SSN cannot be matched. The letters request that the reported information be reviewed, verified, or corrected where possible, and returned to the SSA. These letters are mailed to the address reported on the individuals' Form W-2.

If a Form W-2 does not have an address, or if the reported address is not found in the U.S. Postal Service database of valid addresses, a DECOR letter is sent to the employer. These letters are called "employer DECOR letters" (see www.nilc.org/immsemplmnt/ssa-nm_toolkit/DECORE_Employer_itr.pdf). The SSA reports that employer DECOR letters were also suspended.

Other SSA letters

There are two other types of notices that the SSA sends in connection with W-2s, but in these cases there is no mismatch. These letters were not suspended.

EAD notices. The SSA sends an EAD (earnings after death) notice to both the employer and employee when the employer has reported someone who, according to SSA records, is dead.

YCER notices. The SSA sends a YCER (young children's earnings record) notice to both the employer and employee when the employer has reported wages for someone who, according to SSA records, is under seven years of age. *Note:* The SSA reports that many of these W-2s are valid – e.g., in the case of a child actor. ■

DOL Updates COBRA Model Notices for Extended Premium Subsidy

The U.S. Department of Labor (DOL) has announced [75 F.R. 2562, 1-15-10; <http://edocket.access.gpo.gov/2010/pdf/2010-752.pdf>] the availability of a set of revised model health care continuation coverage notices as required by the American Recovery and Reinvestment Act of 2009 (ARRA). The revised notices were prepared following enactment of the Department of Defense Appropriations Act, 2010 (2010 DOD Act) on December 19, 2009, which extended the availability of the premium reduction for COBRA health care continuation coverage under ARRA (see [PAYROLL CURRENTLY](#), Issue No. 1, Vol. 18). Each of the new packages created by the DOL is designed for a particular group of beneficiaries and contains all of the information needed to satisfy the content requirements for ARRA's amended notice provisions. The revised notices are available on the APA website at www.americanpayroll.org/members/Forms-Pubs/#arra.

General Notice

Plans subject to federal COBRA provisions must provide the updated General Notice to ALL qualified beneficiaries, not just covered employees, who experience a qualifying event through February 28, 2010, regardless of the type of qualifying event, and who have not yet been provided an election notice (the abbreviated version of this notice has been eliminated).

This model notice includes updated information on the premium reduction as well as information required

in a COBRA election notice. Using this model to provide notice to individuals who have experienced any qualifying event from September 1, 2008, through February 28, 2010, will satisfy existing DOL requirements for the content of a COBRA election notice as well as those imposed by ARRA, as amended by the 2010 DOD Act.

Note: Individuals who experienced a qualifying event (that was a termination of employment) in December 2009 but who were not eligible for COBRA coverage until January 2010 were likely not provided proper notice. These individuals should get the updated General Notice AND a full 60 days from the date the notice is provided to make a COBRA election.

Alternative Notice

Insurers that provide group health insurance coverage must send the updated Alternative Notice to persons who became eligible for continuation coverage under a state law. The Alternative Notice must include specified information and be provided to ALL qualified beneficiaries, not just covered employees, who have experienced a qualifying event through February 28, 2010. The DOL has updated the earlier version of this model notice. However, because continuation coverage requirements vary among states, it should be modified to reflect the requirements of applicable state law. Issuers of group health insurance coverage subject to this notice requirement should feel free to use the model Alternative

Notice or the model General Notice (as appropriate).

Premium Assistance Extension Notice

Plan administrators must provide notice to certain individuals who have already been provided a COBRA election notice that did not include information regarding ARRA, as amended by the 2010 DOD Act. This notice serves several purposes and may be used in any of the following circumstances:

- It serves as a notice of the extension of premium assistance from nine to 15 months for individuals who were receiving premium assistance as of October 31, 2009.

- It also provides this information to individuals who became assistance eligible individuals, or who experienced a qualifying event that was the termination of a covered employee's employment between October 31, 2009, and December 19, 2009, but who were provided a notice that did not include the information required by ARRA, as amended by the 2010 DOD Act. Notices for these individuals must be provided by February 17, 2010.

- Additionally, this notice may be used to notify

individuals who are in a "transition period" of their new right to make a retroactive, reduced payment. The transition period is the first period of coverage for which the premium assistance would apply due to the extension from nine to 15 months. These individuals have received the full nine months of premium assistance required under ARRA and either did not make any payment for subsequent periods of coverage, made a payment of 35% (or any amount that is less than 100% of the full premium), or made a payment of the full premium otherwise required to maintain coverage absent the subsidy. The notice must be provided to these individuals within the first 60 days of their transition period.

Fact Sheet and FAQs also available

The DOL has issued a Fact Sheet [www.dol.gov/ebsa/newsroom/fscobrapremiumreduction.html] and FAQs [www.dol.gov/ebsa/faqs/faq-cobra-premiumreductionEE.html] on changes regarding COBRA continuation coverage under ARRA, as amended by the 2010 DOD Act – including changes in the notice requirements. ■

IRS Re-Issues Circular E

The IRS has posted a note on its website [www.irs.gov/formspubs/article/0,,id=109875,00.html] (1-14-10) advising taxpayers that Publication 15 (Circular E), *Employer's Tax Guide* (2010) was modified and reissued on January 8, 2010. This latest version of Publication 15 is available on the APA website at www.americanpayroll.org/members/Forms-Pubs/#pubs. Note: Anyone who was mailed a hard copy of Publication 15 with a release date of December 17, 2009 (see the bottom left-hand corner of the front cover) will be mailed a special notice with these updates.

- *Page 1.* The paragraph that referenced the *American Recovery and Reinvestment Act* has been removed. Due to recently enacted legislation, a new item titled *COBRA premium assistance credit extended* has been added.

- *Page 3.* The paragraph titled *COBRA premium assistance credit* has been removed.

- *Page 7.* Under the section titled *COBRA premium assistance credit*, the third paragraph has been revised to add the extended eligibility period and period of assistance for the COBRA premium assistance credit – from December 31, 2009,

to February 28, 2010, and from nine months to 15 months, respectively. Also, a new fourth paragraph provides guidance on the required notification to eligible terminated employees of the COBRA premium assistance.

In the second column, the last sentence in the third paragraph has been replaced with the following two sentences: "The Department of Defense Appropriations Act of 2010 (DDAA) extended the end of the eligibility period from December 31, 2009, to February 28, 2010. DDAA also extended the period of assistance from 9 months to 15 months."

In addition, the following new fourth paragraph has been added: "Administrators of the group health plans (or other entities) that provide or administer COBRA continuation coverage must provide notice to assistance eligible individuals of the COBRA premium assistance. Any individual who became a COBRA premium assistance eligible individual on or after October 31, 2009, must be sent a notice about the extended provisions of DDAA." ■

IRS Releases Form 1099-MISC for 2010

The IRS has released Form 1099-MISC, *Miscellaneous Income*, for 2010. The form is virtually unchanged from 2009. Both the form and the 2010 Instructions for Form 1099-MISC are available on the APA website at www.americanpayroll.org/members/Forms-Pubs/#tax. This form is used by businesses to report certain payments to nonemployees (e.g., independent contractors, health care providers, attorneys). One *What's New* item is highlighted for 2010:

Truncating recipient's identification number on paper payee statements. Notice 2009-93 (see PAYROLL CURRENTLY, Issue No. 23, Vol. 17 and Issue No. 1, Vol. 18) allows filers of this form to truncate (i.e., show only the last four numbers of) an individual payee's taxpayer identification number (social security number (SSN), individual taxpayer identification number (ITIN), or adoption taxpayer identification number (ATIN)) on paper payee statements for tax years 2009 and 2010. ■

IRS Releases 2010 Pub 15-A, Employer's Supplemental Tax Guide

The 2010 supplement to Circular E, *Employer's Supplemental Tax Guide* (Pub. 15-A), has been released by the IRS. Pub. 15-A contains specialized and detailed employment tax information. The publication is available on the APA website at

www.americanpayroll.org/members/Forms-Pubs/#annual. Items to note include:

- **Verifying social security numbers.** Starting fall 2009, the Social Security Administration (SSA) is no longer manually

verifying social security numbers (SSNs) over the telephone (see [PAYROLL CURRENTLY, Issue No. 19, Vol. 17](#)). SSA now offers an automated telephone service, Telephone Number Employer Verification (TNEV), that lets employers and authorized reporting agents verify up to 10 employee names and SSNs. Anyone wishing to use TNEV must first register to use the SSA's online Social Security Number Verification Service.

- **Optional additional withholding adjustment for pensions.** An optional procedure and additional withholding tables are provided in Publication 15 (Circular E) for figuring the amount of income tax to withhold from pension payments (see [PAYROLL CURRENTLY, Issue No. 23, Vol. 17](#)).

- **Extension and expansion of the COBRA premium assistance credit.** The eligibility period for COBRA continuation coverage has been extended from December 31, 2009, to February 28, 2010, and the maximum period of assistance has been expanded from nine months to 15 months (see [PAYROLL CURRENTLY, Issue No. 1, Vol. 18](#)).

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

Each employee participating must consent (or receive confirmation of any consent given using a paper document) electronically, and must be notified of all hardware and software requirements to receive the forms (see *The Payroll Source*®, pp. 8-68 to 8-70 for further details).

- **Electronic submission of Forms W-4 and W-5.** An employer may set up a system to electronically receive any or all of the following forms (and their Spanish versions, if available) from an employee or payee: Form W-4 (*Employee's Withholding Allowance Certificate*), Form W-4P (*Withholding Certificate for Pension or Annuity Payments*), Form W-4S (*Request for Federal Income Tax Withholding From Sick Pay*), Form W-4V (*Voluntary Withholding Request*), and Form W-5 (*Earned Income Credit Advance Payment Certificate*). If you establish an electronic system to receive any of these forms, you do not need to process that form in a paper version (see *The Payroll Source*®, pp. 6-17 and 6-18 for further details).

- **Employers can choose to file Forms 941 instead of Form 944 for 2010.** Beginning with tax year 2010, employers that would otherwise be required to file Form 944 can notify the IRS if they want to file quarterly Form 941 instead of annual Form 944 (see [PAYROLL CURRENTLY, Issue No. 22, Vol. 17](#)). ■

IRPAC Comments on Pilot Program Permitting Truncation of Certain Payee TINs

In a letter to the IRS dated December 18, 2009, Information Reporting Program Advisory Committee (IRPAC) Chair, Jon Lakritz, requested that the IRS expand the pilot program that allows filers of certain information returns to truncate (i.e., report only the last four digits of) an individual payee's nine-digit identifying number on paper payee statements for calendar years 2009 and 2010 (Notice 2009-93; see [PAYROLL CURRENTLY, Issue No. 23, Vol. 17](#)). The pilot program only applies to paper payee statements in the Form 1098 series, Form 1099 series, and Form 5498 series. It does not apply to any information return filed with the IRS or any payee statement furnished electronically.

The IRPAC letter includes the following comments on the pilot program:

Support for truncation of Employer Identification Numbers (EINs)

First, IRPAC recommends that the IRS permit payers to truncate EINs on payee statements. Notice 2009-93 allows truncation of Taxpayer Identification Numbers (TINs) issued to individuals (e.g., social security numbers), but not EINs, which are issued to entities. Thus, a payer is required to distinguish EINs from other types of TINs in order to participate in the pilot program.

IRPAC asserts that the requirement to distinguish EINs from other types of TINs is preventing payers from participating in the pilot program. Payers have historically not been required to determine the type of TIN they receive from a payee. In fact, many payers do not currently know the type of TIN they have on file for each payee, and are unprepared for the sudden emergence of the new requirement.

Identity theft poses a greater risk to individuals than it does to entities, which is apparently why Notice 2009-93 only allows truncating TINs that are issued to individuals. However, prohibiting EIN truncation seemingly serves little or no purpose but to prevent payers from participating in the

pilot program.

IRPAC believes strongly that EIN truncation should be permitted, and believes it important enough that Notice 2009-93 should be revised to allow EIN truncation for all years of the pilot, including tax year 2009 reporting in 2010. This change would allow for wider participation in the pilot program, which would give the IRS better data when analyzing the ultimate move from a pilot to full production.

Support for truncation on electronically delivered statements

Second, IRPAC looks to reverse the electronic delivery disallowance. Notice 2009-93 supports truncation on paper delivery and explicitly disallows it on electronic delivery. IRPAC recommends that truncation be allowed on electronic delivery of forms as well as paper forms for the following reasons:

- **Difficulties in developing payee statements using two modes.** Payers develop 1099 payee statements through a separate software program or service that pulls from a central processing system. The program that generates statements is independent from the program used to prepare data for files that are transmitted to the IRS. The only exceptions are small payers that file paper 1099s from the same operation. Whether the payee statement is developed for shipment to a print facility or set up for electronic delivery, the process for most payers is the same. By limiting the truncation to hard copies, it will make the development process more complex. Changing the requirements of one output and not the other will cause payers to create a separate process for paper mailings that many may not be able to do, and it will limit participation in the pilot program.

- **Market discrimination in imposing a rule that supports some payers and not others.** Many large payers function only in e-services. There are e-service brokers, banks, and other financial institutions that will not be able to use

this process for most of their clients who currently accept e-delivery of their 1099s by choice. Paper statements are very rare for these payers, thus making the rules a market constraint for them as well as putting them at a competitive disadvantage.

- **Identity theft presents a great risk in both paper and e-delivery modes.** The IRS has done a thorough job of developing requirements for securing the electronic delivery of information reports. The truncation of TINs would complete those requirements. IRPAC believes there is a significant reason to truncate TINs in electronic delivery to avoid identity theft. Major vulnerabilities to identity theft lie in electronic delivery whether the data is stolen from a misappropriated laptop or inappropriately shared through a public server or even through public WIFI use. If the TIN was truncated, that vulnerability would be greatly reduced. IRPAC strongly recommends extending the truncation rules to electronic

delivery as soon as possible.

Expansion of forms supported

Third, IRPAC recommends that other key forms be included in the pilot. The committee believes that adding Forms 3921 (*Exercise of an Incentive Stock Option Under Section 422(b)*) and 3922 (*Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)*) to the pilot will provide better data to evaluate its success.

Extension of the pilot

The letter concludes with the comment that the late release of Notice 2009-93, in addition to its constraints, will substantially limit the number of payers able to participate in the pilot program. Therefore, IRPAC recommends that the IRS modify the effective years of the pilot to include tax year 2011. This change will provide the IRS with two years of complete data to evaluate the program with the broadest participation possible. ■

IRS Issues Guidance Illustrating Rules for Correcting Employment Tax Reporting Errors Using New ‘X’ Series Forms: Part II

The IRS has issued guidance illustrating the interest-free adjustment and claim for refund processes under final regulations that changed employment tax adjustment procedures in connection with the development of new “X” forms – e.g., Form 941-X (see [PAYROLL CURRENTLY, Issue No. 15, Vol. 16](#)). The revenue ruling applies the final regulations to a variety of situations to show how the new processes operate [Rev. Rul. 2009-39, 12-10-09; www.irs.gov/pub/irs-drop/rr-09-39.pdf]. The last issue of [PAYROLL CURRENTLY](#) included four situations. This issue includes four more situations.

An overpayment of FICA tax when the error is ascertained close to the expiration of the period of limitations on credit or refund

Big Farm, Inc. timely filed its 2006 Form 943 on January 26, 2007, and timely paid all employment tax reported on the return. On April 5, 2010, Big Farm ascertains that it overpaid FICA tax on wages paid to its employees on its 2006 Form 943. Big Farm does not have sufficient time to repay or reimburse its employees or obtain their consents and also timely file a claim for refund.

In order to correct the overpayment, Big Farm must file Form 943-X, *Adjusted Employer's Annual Federal Tax Return for Agricultural Employees or Claim for Refund*. Big Farm may not correct the error using the adjustment process because the error was ascertained too late for the adjusted return to be filed by January 15, 2010, as required under the 90-day rule. To correct the error using the refund claim process, Big Farm must file Form 943-X by April 15, 2010, in order for the claim to be timely.

Note: Under Treas. Reg. §31.6413(a)-2(d)(2), no overpayment adjustment may be made if the overpayment relates to a return period for which the period of limitations on credit or refund under IRC §6511 will expire within 90 days of filing the adjusted return. The purpose of the 90-day rule is to give the IRS sufficient time to process the request for an overpayment adjustment.

Notwithstanding the fact that Big Farm has not repaid or reimbursed its employees or obtained its employees' consents, if Big Farm files Form 943-X by April 15, 2010, the claim will be considered timely filed. However, before the IRS can grant the claim, Big Farm must certify that it has repaid or reimbursed its employees, or obtained their consents, and secured the employees' written statements confirming that the employees have not made any previous claims (or the claims were rejected)

and will not make any future claims for refund or credit of the amount of the overcollected FICA tax.

An underpayment of FICA tax and income tax withholding (ITW) ascertained in the course of an employment tax examination

In 2010, in the course of an employment tax examination, the IRS determines that Yowza Co. underpaid FICA tax and ITW with respect to wages of its employees on its 2008 fourth quarter Form 941. Yowza signs Form 2504, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (Excise or Employment Tax)*, to agree to the assessment and submits it to the examiner during the employment tax examination.

The determination by the IRS that Yowza underpaid FICA tax and ITW on its fourth quarter Form 941 is treated as an error ascertained at the time Yowza submits the signed Form 2504. Submitting a signed Form 2504 satisfies the requirement that an adjusted return be filed; therefore Yowza is entitled to an interest-free adjustment.

While the error was not ascertained in the same year that the wages were paid to the employees, the interest-free adjustment applies to both the FICA tax and ITW because the adjustment is reported on a signed Form 2504. In order for the adjustment to be entirely interest-free, Yowza must pay the amount due when it submits the signed Form 2504. Otherwise, interest will accrue from the date Yowza submits the signed Form 2504. Because an adjusted return (i.e., Form 2504) was filed, even if payment is not made until after receipt of notice and demand, Yowza is nevertheless entitled to interest-free treatment up to the date it submits the signed Form 2504; however, interest will accrue from the date the signed Form 2504 is submitted until the date of payment.

An underpayment of FICA tax and ITW ascertained in the course of the appeals process

Assume the same facts as in the previous situation, except that Yowza Co. does not agree with the examiner's determination and exercises its appeal rights. No agreement is reached in Appeals. An Appeals closing letter, dated November 3, 2010, is sent to Yowza informing Yowza that it will receive notice and demand for payment of tax and interest owed and that it has the right to contest the Appeals' determination in the U.S. District

Court or the U.S. Court of Federal Claims if it files a refund claim and later sues for a refund. The determination by Appeals that Yowza underpaid FICA tax and ITW on its 2008 fourth quarter Form 941 is treated as an error ascertained on November 3, 2010, the date of the Appeals closing letter.

Because Yowza does not submit a signed Form 2504, an adjusted return has not been filed. As a result, no interest-free adjustment has been made, and Yowza owes the amount due plus interest accrued from the due date of the return for which the underpayment was made (i.e., February 2, 2009, the due date of the return for the 2008 fourth quarter Form 941). However, if Yowza submits a signed Form 2504 by the due date of the return for the return period in which the error was ascertained (i.e., January 31, 2011) and before receipt of notice and demand for payment, Yowza is entitled to an interest-free adjustment. Submitting a signed Form 2504 will not prevent Yowza from filing a refund claim to make it possible to contest its liability in court.

If Yowza does not submit a signed Form 2504 by January 31, 2011, but pays the amount due prior to receiving notice and

demand, Yowza has not made an interest-free adjustment and will owe interest accrued from the date of the return for which the underpayment was made (i.e., from February 2, 2009).

An underpayment of FICA tax and ITW resulting from the misclassification of employees ascertained in the course of the appeals process

In 2011, in the course of an employment tax examination, the IRS determines that Gee Whiz Biz, Inc. misclassified some of its employees as independent contractors for the first quarter of 2009. Gee Whiz does not agree with the examiner's determination and exercises its appeal rights. No agreement is reached in Appeals, and Gee Whiz does not sign Form 2504-WC; however, Gee Whiz makes a cash bond deposit to stop the accrual of interest. A Notice of Determination is issued, and Gee Whiz subsequently files a petition with the U.S. Tax Court.

The error is treated as having been ascertained at the time Gee Whiz makes the cash bond deposit. Because Gee Whiz made a cash bond deposit prior to receiving the Notice of Determination, it is entitled to an interest-free adjustment. ■

IRS Issues Guidance on Differential Military Pay

The IRS has issued preliminary guidance on certain provisions of the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 (see [PAYROLL CURRENTLY, Issue No. 11, Vol. 16](#)) in the form of questions and answers [Notice 2010-15, 1-20-10; www.irs.gov/pub/irs-drop/n-10-15.pdf]. The guidance covers the following:

- Treatment of differential military pay as wages (i.e., whether differential wage payments must be treated as compensation for purposes of determining contributions and benefits under a plan; differential wage payments and IRC §414(s), where differential wage payments are excluded from the plan's definition of compensation for purposes of determining benefits and contributions under the plan; applicability of new §414(u)(12)(B), which treats an individual as severed from employment while performing service in the uniformed services; and whether contributions and benefits provided as a result of differential wage payments may be included in a plan's discrimination testing);

- Distributions from retirement plans to individuals called to active duty;
- Survivor and disability payments with respect to qualified military service;
- Contributions of military death gratuities to Roth IRAs and Coverdell education savings accounts; and
- An employer credit for differential wage payments to employees who are active duty members of the uniformed services.

Comments

The IRS is considering additional guidance on these sections of the HEART Act, and comments are requested on what it might include. Send written comments to: CC:PA:LPD:DRU, Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: www.regulations.gov. Be sure to reference Notice 2010-15. ■

Wage & Hour Roundup

The U.S. Department of Labor recently concluded the following Fair Labor Standards Act (FLSA) enforcement actions.

Overtime: straight time

Plattner Automotive Group, a Sarasota, FL-based company that operates 11 automotive dealerships in the state, has agreed to pay \$71,129 in back overtime wages to 61 nonexempt employees. DOL Wage & Hour Division investigators found that the employer paid these workers the required minimum wage for a set number of hours, which was less than the number of hours they actually worked. In addition, the workers did not receive any overtime premium for hours worked over 40 in a workweek.

Overtime: incentive pay

RBG USA, Inc., which provides services to oil, gas, and petrochemical and wind power industries throughout the U.S., has agreed to pay \$394,721 in back overtime wages to 482 contract engineers and construction technical personnel in

Sugarland, TX and Cohocton, NY. W-H investigators found that the company failed to include hourly incentive pay (\$7-\$12 per hour) in the workers' regular rate of pay when computing overtime.

Overtime: bonuses

Stone and Webster Construction, Inc., of Pueblo, CO, has paid \$562,901 in back overtime wages to 1,411 construction workers. W-H investigators found that the company did not include retention bonuses and daily bonuses in the regular rate of pay when computing overtime pay for these employees.

Overtime: misclassified workers

A U.S. District Court in Santa Ana, CA, has ordered Southern California Maid Service and Carpet Cleaning, Inc. to pay \$3.5 million in back wages, plus interest, fines, and liquidated damages, to 385 workers. The court found that the company wrongly classified its home and carpet cleaners as independent contractors and failed to pay overtime for hours worked over 40 in a workweek.

The court originally awarded back wages and liquidated damages to the workers in 2007, but the amounts were unpaid for two years. At that point, the court added daily fines to the total due. In October 2009, the owners of the business were taken into custody; they were released after promising to pay.

Child labor: hours and time standards

Western Wats Center, Inc., an Orem, UT-based market research company with locations in seven states, has been assessed \$552,750 in civil money penalties for violating the FLSA's child labor provisions. These penalties are among the

highest ever assessed by the DOL. W-H investigators found that the company employed 1,482 minors – three age 13 and the rest ages 14 and 15 – contrary to hours and time standards. The minors worked as interviewers at the company's phone centers.

Note: Children under 14 years of age may not be employed in non-agricultural occupations covered by the FLSA; those 14 and 15 years of age may be employed outside of school hours in various non-manufacturing and non-hazardous jobs for limited periods of time and under specified conditions. ■

TIGTA Report Says IRS Issues ITINs With Insufficient Documentation

In a recently issued report, the Treasury Inspector General for Tax Administration (TIGTA) presents the results of a review to determine whether applications for IRS Individual Taxpayer Identification Numbers (ITINs) are being issued without sufficient supporting documentation – i.e., whether Forms W-7 (*Application for IRS Individual Taxpayer Identification Number*) are being efficiently and effectively processed and ITINs appropriately issued. The report concludes that ITINs are being issued without sufficient supporting documentation [2010-40-005; www.treas.gov/tigta/auditreports/2010reports/201040005fr.pdf].

Background

The ITIN was created to provide individuals who are not eligible to obtain a social security number (SSN) with an identification number for tax purposes. The IRS issues ITINs to help individuals comply with federal tax laws and provide a means to efficiently process and account for tax returns. Only an individual who has a valid filing requirement or is filing a tax return to claim a refund of overwithheld tax is eligible to receive an ITIN. An ITIN is issued regardless of an individual's immigration status. The issuance of an ITIN does *not*:

- change an individual's immigration status;
- entitle the individual to social security benefits;
- entitle the individual to work in the U.S.; or
- entitle the individual to the Earned Income Tax Credit.

ITINs are not valid outside the tax system. The IRS began processing Forms W-7 in July 1996 and estimates that, as of December 2008, it has issued more than 14 million ITINs. Individuals apply for an ITIN by completing a Form W-7 and using one of the following methods:

- submitting Form W-7 through an IRS-approved Acceptance Agent or Certified Acceptance Agent; or
- applying directly to the IRS:
 - mailing Form W-7 with substantiating documentation and a completed tax return to the IRS ITIN unit (Austin campus); or
 - submitting Form W-7 personally to an IRS Taxpayer Assistance Center with substantiating information and a completed tax return.

Findings

Supporting documentation errors. TIGTA found that ITINs were issued without sufficient supporting documentation. A statistical sample of 658 Forms W-7 selected from 1.5 million application packages submitted from January 1 through November 21, 2008, showed that 78% contained errors. The highest error rate (87%) was in applications submitted through Certified Acceptance Agents. This included instances in which the agents did not provide the documents required to support the Forms W-7. However, there was also a significant error rate (35%) in application packages submitted directly to the IRS by

individual applicants.

Complexity of documents, inconsistency of guidance.

Supporting documents are complex and guidelines are inconsistent, which creates confusion for taxpayers and agents attempting to properly prepare a Form W-7 and identify the documents needed to support the issuance of an ITIN.

Use of ITINs on multiple tax returns. There are also no controls to prevent an ITIN from being used by more than one taxpayer on multiple tax returns. As with SSNs, ITINs are specific to individuals and should be issued to and used by one individual. TIGTA found that more than 60,000 ITINs were assigned and used on multiple tax returns processed in calendar year 2008. In addition, more than 55,000 ITINs were used multiple times on approximately 102,000 tax returns with refunds totaling more than \$202 million.

Real-Time System. IRS employees review and process applications submitted directly by individual applicants. However, IRS employees process, but do not review, applications submitted by Certified Acceptance Agents. They input the information from these Forms W-7 into the ITIN management information system – called the Real-Time System. If all requirements are met, an ITIN is assigned automatically by the system.

TIGTA concluded that the Real-Time System contains inaccurate data and is insufficient to oversee the program. Auditors found that 49% of the records in the sample it examined contained inaccurate information relating to what type of agent submitted the application. In other words, the IRS does not know the volume of Forms W-7 submitted by Certified Acceptance Agents – who therefore may not be included in any compliance activity. In addition, information on 20% of the Forms W-7 examined was not transcribed correctly to the system. Transcription errors included incorrect identification documents, birth dates, codes/reasons for submitting the Forms W-7, names, and/or addresses.

Recommendations

TIGTA recommended revision of IRS guidelines:

- related to processing applications submitted by Certified Acceptance Agents to ensure that the Forms W-7 match the information on the certificates of accuracy before issuing ITINs and to ensure that any supporting documents submitted with the certificates of accuracy are reviewed with the same due diligence required for Forms W-7 submitted directly by individual applicants;
- related to processing applications submitted directly by individual applicants to ensure that all information on the Forms W-7 is validated and consistent with supporting documentation; and
- to ensure that the instructions for completing the Form W-7 and internal guidelines are consistent by clarifying various

items.

In addition, TIGTA said the IRS should:

- develop controls to prevent ITINs from being used on multiple tax returns (IRS says tax returns submitted with a duplicate secondary/dependent ITIN are subject to audit after processing, while TIGTA says controls should be developed

during processing before tax refunds are issued);

- ensure that the data on the Real-Time System is accurate; and
- develop procedures and internal controls to monitor the Real-Time System to ensure that information entered is accurate. ■

IRS Creates Web Page for Payroll Professionals

The IRS has created a new page on its website for payroll professionals, consolidating a variety of payroll tax information for this target audience. The Payroll Professionals Tax Center is accessible at www.irs.gov/businesses/small/industries/article/0,,id=185188,00.html.

Find links to:

- information on employment taxes for businesses – employment taxes and deposit and reporting rules;
- provisions of the American Recovery and Reinvestment Act of 2009 that affect employers and payroll providers, including the Making Work Pay Tax Credit and the COBRA Health Insurance Continuation Subsidy;
- topics employers should know, such as part-time and seasonal help, hiring employees, and employer identification numbers (EIN);
- information on worker classification (independent contractors vs. employees), including the common law rules for determining employee status and the consequences of misclassifying a worker as an independent contractor;
- employment tax forms and publications;
- draft forms and instructions, including a schedule of release dates;
- information on correcting employment taxes;

- tax pro events, listing upcoming educational events in a variety of formats;
- information and guidance for reporting agents;
- a variety of IRS electronic newsletters plus the Social Security Administration's *W-2 News*, the *SSA/IRS Reporter*, and the SSA's employer web page;
- information on electronic options, including:
 - help-line telephone numbers, information about how to file returns electronically, and information on backup withholding and the "B" notice process;
 - the FIRE (Filing Information Returns Electronically) system (Forms 1042-S, 1099);
 - the TIN (Taxpayer Identification Number) matching service (Forms 1099);
 - employment tax electronic and payment options (Forms 940, 941, 944);
 - the Electronic Federal Tax Payment System (EFTPS);
- other information, including:
 - outsourcing payroll (payroll service providers);
 - retirement plans for small businesses; and
 - Earned Income Tax Credit (EITC) information for employers. ■

IRS Issues Guidance on NQDC Plan 'Document Correction Program'

The IRS has issued guidance describing a new "document correction program" that permits taxpayers to correct certain failures of a nonqualified deferred compensation (NQDC) plan to comply with the plan document requirements of IRC §409A, or in certain circumstances to limit the amount includible in income and additional taxes under §409A as a result of a plan document failure [Notice 2010-06, 1-5-10; www.irs.gov/pub/irs-drop/n-10-06.pdf].

Document failure. The document correction program described in Notice 2010-06 is intended to encourage taxpayers to review NQDC plans to identify provisions that fail to comply with the requirements of §409A and Treas. Reg. §1.409A-1(c) (a document failure), and to correct those plan provisions promptly, while also not providing an advantage to taxpayers participating in plans that initially fail to comply with §409A over taxpayers participating in plans drafted in compliance with §409A. The notice provides:

- Clarification that certain language commonly included in plan documents will not cause a document failure.
- Relief permitting correction of certain document failures without current income inclusion or additional taxes under §409A, provided, in certain circumstances, that the corrected plan provision does not affect the operation of the plan within one year following the date of correction.
- Relief limiting the amount currently includible in income and the additional taxes under §409A for certain document failures if correction of the failure affects the

operation of the plan within one year following the date of correction.

- Relief permitting correction of certain document failures without current income inclusion or additional taxes under §409A, if the plan is the employer's first plan of that type (disregarding any plans not subject to §409A or any plans under which all deferred amounts have previously been paid or forfeited) and the failure is corrected within a limited period following adoption of the plan.

- Transition relief permitting corrections of certain document failures without current income inclusion or additional taxes under §409A, if the document failure is corrected by December 31, 2010, and any operational failures resulting from the document failure are also corrected in accordance with Notice 2008-113 by December 31, 2010.

Operational failure. Notice 2010-06 also clarifies aspects of Notice 2008-113 (see **PAYROLL CURRENTLY, Issue No. 1, Vol. 17; www.irs.gov/pub/irs-drop/n-08-113.pdf**), which addresses certain failures of NQDC plans to comply with §409A in operation (operational failures), including:

- The application of the subsequent year correction method to late payments of amounts deferred.
- The calculation of the amount that must be paid to the employee as a correction of a late payment of an amount deferred under a plan if the payment would have been made in property, such as shares of stock.

- The calculation of the amount that must be repaid by the employee as a correction of an early payment of an amount deferred under a plan if the early payment was made in property, such as shares of stock.

Eligibility

A taxpayer claiming the relief provided in Notice 2010-06 must show that all applicable requirements (as spelled out in the Notice) have been met. In addition, the relief provided in Notice 2010-06 is not available: (1) unless the employer takes commercially reasonable steps to identify all other NQDC plans with a document failure that is substantially similar to the document failure initially identified and corrected and corrects all such failures in a manner consistent with the notice; (2) if a federal income tax return of the employee or employer is under examination with respect to NQDC for any taxable year in which the document failure existed; or (3) for intentional failures or if a failure is directly or indirectly related to participation in a listed transaction under IRS Reg. §1.6011-4(b)(2).

Moreover, the relief provided in Notice 2010-06 may be conditioned on: (1) the employee including amounts deferred in income under §409A; or (2) the plan being amended to adopt a new or modified payment event or an amount deferred.

Effective date

Taxpayers may rely on Notice 2010-06 for taxable years beginning on or after January 1, 2009.

Notice 2008-115. The modifications to Notice 2008-113 (relating to operational corrections) are effective for employee taxable years beginning on or after January 1, 2010, but

may be relied on by taxpayers for employee taxable years beginning before that date. *Note:* Notice 2010-06 does not otherwise affect the guidance provided in Notice 2008-113.

Notice 2008-115. For employers and employees entitled to relief under Notice 2010-06, Notice 2008-115 (see *PAYROLL CURRENTLY*, Issue No. 26, Vol. 16; www.irs.gov/pub/irs-drop/n-08-115.pdf), relating to reporting and wage withholding for 2008 and subsequent years, is modified with respect to: (1) the amount that is required to be included in income by an employee under §409A(a); and (2) the amount that is required to be reported by the employer as an amount includible in income under §409A(a) on Form W-2.

The modifications to Notice 2008-115 (relating to reporting and wage withholding for 2008 and subsequent years) are generally effective for employee taxable years beginning on or after January 1, 2009. However, the modifications to Notice 2008-115 as a result of the guidance modifying Notice 2008-113 (relating to operational corrections) are effective for employee taxable years beginning on or after January 1, 2010, but may be relied on by taxpayers for employee taxable years beginning before that date.

Comments

Comments are requested on other document failures that commonly occur and methods to correct them. Comments must be submitted by April 5, 2010. Submit written comments to: CC:PA:LPD:RU (Notice 2010-06), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically to: Notice.comments@irs.counsel.treas.gov. Be sure to include the notice number (Notice 2010-06) in the subject line. ■

Some Fellowship Stipends Were Subject to FICA Tax, Others Were Not

In a legal memorandum, the IRS advises a university that stipends paid to post-doctoral fellows through National Research Service Award (NRSA) grants were not FICA-taxable wages; however, stipends under non-NRSA grants were subject to FICA tax [CCA 200944027, 7-22-09; www.irs.gov/pub/irs-wd/0944027.pdf].

Background

A state university has various departments and programs that perform research. To fund the research, the university applies for grants from public and private sources. In addition to faculty members, the university hires post-doctoral fellows to work on the funded research projects. Post-doctoral fellowships are open to those who have received doctoral degrees from the university or elsewhere. The university compensates its post-doctoral fellows with stipends paid from either NRSA grants or other sources.

Note: Fellowship grants are subject to FICA tax if they constitute wages under IRC §3121(a), which are generally defined as amounts paid as remuneration for employment.

NRSA grant stipends not subject to FICA tax

Amounts received by post-doctoral fellows under NRSA grants are not subject to FICA tax because they are not remuneration for employment. NRSA grants are awarded by the U.S. Department of Health and Human Services (HHS) to enable post-doctoral fellows to engage in research and research training. Fellows seeking NRSA grants apply directly to HHS; if the application is approved, HHS makes payments to the host institution, which, in turn, pays a stipend to the applicant.

NRSA grants do not require post-doctoral fellows to provide any particular quantity or quality of research to the university or anyone else. The primary purpose of NRSA grants is to further the research training of post-doctoral fellows. The NRSA application and award process requires each grant to be tailored to an individual's training and development rather than the goals of the university or HHS. Progress reports focus on the development of research skills rather than research accomplishments. Moreover, HHS does not evaluate or require the university to consider the contribution the awardee will make to a research project.

HHS requires grant recipients to pursue their research training on a full-time basis. Awardees of NRSA grants prepare periodic progress reports detailing the research they have performed and the research training they have received. HHS does not require awardees to obtain its approval before changing the focus of their research.

In addition to award payments, awardees receive benefits (other than retirement benefits, which are not allowed), such as holiday and vacation pay, paid sick leave, and health and dental insurance. Finally, the intellectual property that awardees produce is their own, subject only to a requirement that they acknowledge HHS support; they are free to copyright their publications or patent their inventions.

Non-NRSA grant stipends subject to FICA tax

The stipends paid to post-doctoral fellows from non-NRSA grants are subject to FICA tax because they are remuneration for employment. The university, not the post-doctoral fellow, applies for non-NRSA grants and defines

the nature and scope of work to be performed. To obtain a non-NRSA grant, the university submits an application to a grantor (e.g., the National Institutes of Health, the American Heart Association, Procter & Gamble) describing a particular research project to be undertaken. The post-doctoral fellows are usually not recruited until grant funding is secured.

The university evaluates fellowship applicants based on their ability to provide the particular research services the grants require. The stipends paid to post-doctoral fellows working under non-NRSA grants correspond to the market-rate value of the research services performed.

The fellows are employees of the university, which exercises sufficient behavioral and financial control over them to create an employer-employee relationship. The

university specifies the work that is to be performed and supervises all aspects of the project, monitoring awardees' progress based on the quantity and quality of the research services provided. Fellows must obtain approval prior to changing the direction of their research and have no rights to the intellectual property generated by their work. No compensation is paid for activities unrelated to the university's grant contract with the grantor.

In addition, the university treats the relationship with non-NRSA awardees as an employer-employee relationship – e.g., by providing them with appointment letters detailing the compensation to be paid and services to be performed, referring to “salary” and “wages,” and offering extensive benefits, including retirement benefits. ■

IRS Proposal Would Allow Agents to Handle FUTA Tax Reporting, Payment on Wages Paid for Home Care Services

The IRS has issued proposed regulations under IRC §3504 to allow a home care service recipient to designate an agent to report, file, and pay all employment taxes, including FUTA. This would allow an intermediary to file a single FUTA return on behalf of multiple home care service recipients as the intermediary does currently with respect to income tax withholding and FICA [75 F.R. 1735, 1-13-10; <http://edocket.access.gpo.gov/2010/pdf/2010-415.pdf>].

Authorized agent under §3504

Under IRC §3504, an agent may be authorized to perform specified acts required of employers. All provisions of law (including penalties) applicable to the employer are applicable to the agent and remain applicable to the employer. Accordingly, both the agent and employer are liable for the employment taxes and penalties associated with the employer's employment tax obligations undertaken by the agent.

Under IRC Reg. §31.3504-1, the IRS may authorize an agent to undertake the employment tax obligations of an employer with respect to income tax withholding and FICA taxes. The agent is required to file only one return for each tax return period using the agent's own employer identification number (EIN) regardless of the number of employers for whom the agent acts.

The current regulations do not authorize an agent to undertake the employment tax obligations of an employer with respect to FUTA tax. As a result, separate FUTA returns must be prepared for thousands of individual service recipients reporting small amounts of wages and FUTA tax.

Intermediaries

In the preamble to the proposed regulations, the IRS explains that in recent years many home care service recipients have applied to designate the intermediary that arranges to pay their service providers as an agent under §3504 so that the intermediary can withhold, report, and pay income tax withholding and FICA tax on the service recipient's behalf. Designating these intermediaries as agents reduces the administrative burden on the service recipient, who may not otherwise have an obligation to report, file, or pay employment taxes.

The intermediaries have access to training in how to comply with employment tax requirements and have the payroll information from the payments they make to the service providers. An intermediary that is designated as an agent can efficiently handle reporting, filing, and paying income tax withholding and FICA on behalf of multiple service recipients on

a single return. A service recipient can complete the application to designate the intermediary as an agent at the time the recipient enrolls with the intermediary.

Definitions

Under the proposed regulations, a *home care service recipient* would be defined as an individual who is an enrolled participant in a program administered by a federal, state, or local government agency that provides federal, state, or local funds to pay, in whole or in part, for the provision of home care services. A participant would qualify as a home care service recipient while enrolled in such a program and until the end of the calendar year in which the participant ceases to be enrolled in the program.

Under the proposed regulations, *home care services* would be defined to include health care and personal attendant care services rendered to a home care service recipient in his/her home or local community. Services provided outside the home care service recipient's private home might qualify as home care services for purposes of these regulations (even if they did not qualify as domestic service in a private home of the employer for purposes of §§3121(a)(7), 3306(c)(2), and 3401(a)(3)), so long as they were provided within the service recipient's local community.

Effective date

The regulations are proposed to apply to wages paid on or after January 1 of the calendar year following the date they are published as final. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations.

In addition, taxpayers may apply these proposed regulations to all taxable years for which a valid designation as an agent has been in effect under IRC Reg. §31.3504-1(a). Thus, prior to publication of final regulations, any party already authorized under §3504 to serve as an agent for a home care service recipient, as defined in the proposed regulations, or with an application pending, will not need to file any additional application in order to expand the scope of the agency to cover FUTA taxes.

Comments

Comments on the proposed regulations must be received by April 13, 2010. Send written comments to: CC:PA:LPD:PR, Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: www.regulations.gov. Be sure to reference IRS REG-137036-08 in your submission. ■

ID Card Expense Reimbursements Can Be Excluded From Income Under Accountable Plan

The IRS Office of Chief Counsel has released an internal memorandum concluding that amounts paid to employees as reimbursement for expenses incurred to obtain required forms of identification or changes to current identification pursuant to Homeland Security Presidential Directive (HSPD)-12 are deductible employee business expenses under IRC §162 and thus are excludable from income and wages if made under an accountable plan [Program Manager's Technical Advice 2009-068, 4-14-09; www.irs.gov/pub/iranoa/pmta2009_068.pdf].

Background

HSPD-12 was issued on August 27, 2004, to address concerns regarding terrorism and the internal security of government facilities and data. Pursuant to HSPD-12, all applicable IRS employees and contractors are required to obtain new identification cards.

In order to obtain new identification cards, IRS employees and contractors are required to validate their identity and to present both specified primary and secondary forms of identification. Name information on the forms of identification must match, otherwise enrollment will be denied.

Question 1: Are the costs incurred by current employees to satisfy the requirements of HSPD-12 employee business expenses under IRC §162?

IRC §162(a) allows as a deduction all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Whether an expense is ordinary and necessary is a question of fact. In general, a trade or business expense is ordinary if it is normal, usual, or customary in the taxpayer's type of business. Being an employee constitutes a trade or business for purposes of §162(a).

Expenditures, even ones that seem to be personal, can be deductible if they are required by the employer and are related to the job (Rev. Rul. 75-316). Courts have found expenses deductible where they were related to the employees' performance of their jobs and were required by the employer.

Here, the identification card is required by the employer and is related to the employee's employment. In order to obtain the required identification card, some employees may incur preliminary expenses to validate their identity. While costs incurred to establish identification are a personal expense in most circumstances, here the IRS established procedures that employees must follow in order to obtain the proper identification card. Under such circumstances, these costs incurred by the employees at the direction and mandate of the IRS are appropriately characterized as a business expense, rather than a personal expense.

Consequently, the costs incurred by employees for required identification in order to obtain the required HSPD-12 identification card are deductible employee business expenses under IRC §162(a).

Question 2: When the employee business expenses are reimbursed by the employer, is the reimbursement excluded from income and wages?

IRC §62 defines adjusted gross income as gross income minus certain deductions. Under §62(a)(2)(A), for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of services as an employee of the employer under a reimbursement or other expense allowance arrangement. Section 62(c) lays out basic conditions for such an arrangement, and IRC regulations (§1.62-2(c)(1)) provide that an arrangement must meet the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses in order to be treated as paid under an accountable plan.

Here, employees are reimbursed for expenses incurred to obtain identification cards required for employment. Since the arrangement to reimburse the HSPD-12 expenses satisfies the business connection requirement (discussed previously), if it also satisfies the substantiation and return of excess requirements, then reimbursements made under the arrangement will be treated as made under an accountable plan and will be excluded from the employees' income and wages. ■

Employer Complying With IRS Levy Was Protected by Statutory Immunity

In June 2007, YRC, Inc. received a *Notice of Levy* issued by the Internal Revenue Service. According to the *Notice*, Perry Heaton, an employee of YRC, owed \$127,425.09 in unpaid taxes. In compliance with the *Notice*, YRC began paying over a portion of Heaton's wages to the U.S. Treasury on a weekly basis.

Heaton sued YRC, arguing that compliance with the *Notice of Levy* was wrongful because YRC was paying his federal taxes without consent or court order and because a *Notice* is not a procedurally sufficient method of enforcing a levy.

A U.S. District Court in Minnesota dismissed the case [*Heaton v. YRC, Inc.*, No. cv-09-2807 (D Minn., 12-17-09)], citing IRC §6332(e).

The court explained that Heaton's claims against YRC were barred by IRC §6332(e), which provides that a third

party in possession of property upon which a levy has been issued (e.g., an employer) is "discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to such property or rights to property arising from such surrender or payment." Even if property is erroneously or mistakenly surrendered, §6332(e) protects the third party from any liability arising from the surrender of the property.

The court also explained that Heaton's assertion that a *Notice of Levy* is a procedurally insufficient method of enforcing a levy was "baseless." Heaton's argument rested on a case that was decided under the Internal Revenue Code of 1939. The current version of the IRC no longer refers to a "warrant" to enforce a levy. Without exception, case law supports the use of a *Notice of Levy*. Nothing more is required. ■

No §530 Relief for Company That Treated Salespersons as Independent Contractors

In 2008, a U.S. District Court in Iowa ruled that salespersons for the Porter Livestock Company were employees, not independent contractors (see *PAYROLL CURRENTLY*, Issue No. 1, Vol. 17). The court has now decided that company owner Raymond Porter was not entitled to relief from employment taxes under §530 of the Revenue Act of 1978 [*U.S. v. Porter*, No. 4:05-cv-00464-JEG, 2009 U.S. Dist. LEXIS 82160 (SD Iowa, 7-21-09)].

WHAT THE LAW SAYS – Section 530 of the Revenue Act of 1978 provides relief from employment tax liability in employee classification cases when all of the following requirements are satisfied: (1) the employer has filed all federal tax returns (including information returns) with respect to the worker in question in a manner consistent with treatment of the worker as an independent contractor (reporting consistency requirement); (2) the employer has treated all persons holding substantially similar positions as independent contractors (substantive consistency requirement); and (3) the employer had a reasonable basis for treating the individuals in question as independent contractors. Reliance on judicial precedent, a previous employment tax audit, IRS technical advice, or longstanding industry practice may be used to establish a “reasonable basis” (see *The Payroll Source*®, pp. 1-5, 1-6).

Substantive consistency

Porter satisfied this requirement because the company consistently treated all of its salespersons as independent contractors. John Porter, Raymond Porter’s son, was treated as an independent contractor when he worked as a salesperson, but was treated as an employee when he stopped selling the company’s livestock feed supplements. The only other worker

at the company besides the salespersons, who was involved with office work and feed supplement production, had always been treated by the company as an employee.

Reporting consistency requirement

Previously, Porter submitted an affidavit swearing that the company had provided Forms 1099 to all of the salespersons for 1996 and 1997, the tax years in issue. The IRS agreed that the company had filed Forms 1099 for the salespersons for 1997, but it had no record of receiving them for 1996. Porter then supplied copies of Forms 1099 he claimed to have provided salespersons for 1996, and the salespersons provided copies of their 1099 forms for 1996 and swore that they had received 1099 forms for every year they worked for Porter Livestock. Porter also provided copies of Forms 1096 for 1996 and 1997.

This was evidence in support of Porter’s affidavit, but it was not evidence that he actually filed Forms 1099 for the salespersons in 1996, said the court. Accordingly, Porter failed to satisfy the reporting consistency requirement for §530 relief.

Reasonable basis

Porter could not show that he had a reasonable basis for treating the salespersons as independent contractors. He said his treatment of these workers was based on advice from an attorney, who was deceased. The court explained that although the advice of an attorney or other professional advisor qualifies as technical advice for the purpose of §530 relief, here Porter’s claim that he received legal advice was unsubstantiated. Porter’s assertion that treating livestock-feed salespersons as independent contractors was an industry-wide practice was also unsubstantiated. ■

Employer Couldn’t Offset Payments for Personal and Lunch Minutes Against Compensation Owed to Employees

Employees of Wayne Farms, LLC objected to the company’s use of a master time card to record the work hours of employees assigned to a processing line at its Laurel, Mississippi plant. The employees sued, arguing that this pay practice allowed the company to avoid paying them for time spent on activities that are compensable under the Fair Labor Standards Act (FLSA). A U.S. District Court in Mississippi agreed, ruling that Wayne Farms could not credit payments for personal time and paid lunch against the compensation due its employees under the FLSA [*Agee v. Wayne Farms, LLC*, 626 F. Supp.2d 643 (SD Miss., 1-13-09)].

Wayne Farms paid employees for 11 daily minutes in addition to those minutes actually worked. Six of the

minutes were paid as “personal time.” Five minutes were paid as a result of the company practice of giving employees a 35-minute lunch break but only deducting 30 of those minutes from paid time. With the additional 11 daily minutes factored in, the company argued that the employees no longer had a viable FLSA claim.

The court disagreed, explaining that §207(h) of the FLSA governs the types of compensation that can be credited toward minimum wage and overtime compensation. Generally, amounts excluded from an employee’s regular rate of pay are not creditable toward such wages. Instead, only certain types of “extra compensation provided by a premium rate” can be credited. ■

Employer Willfully Misclassified ‘Product Design Specialist’ as FLSA-Exempt Professional

Andrew Young worked for three years as a “Product Design Specialist II” (PDS II) for Cooper Cameron Corporation. When he was hired, Young had approximately 20 years of engineering-type experience, and his work at Cooper Cameron involved complicated technical expertise and responsibility.

Like all of the other PDS IIs, however, Young lacked any formal education beyond a high school diploma.

Young was not paid overtime because Cooper Cameron had classified PDS IIs as exempt professionals under the Fair Labor Standards Act (FLSA). After losing his job in 2004 due to

a reduction-in-force, Young sued Cooper Cameron for willfully violating the FLSA by classifying him as an exempt professional.

Young was not an exempt professional

There is an exemption from the overtime requirements of the FLSA for persons employed in a bona fide “professional” capacity, which is defined by regulation as work in “a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study” (29 C.F.R. §541.3(a)(1)). *Note:* The 2002 version of the regulations was applicable in this case.

The job of a PDS II required no formal advanced education. The question for the court was whether a position can be exempt notwithstanding the lack of an educational requirement, if the duties actually performed require knowledge of an advanced type in a field of science or learning.

The Second Circuit said that if advanced and specialized education is not customarily required, the exemption cannot apply, regardless of the employee’s duties. “Customarily” makes the exemption applicable to the rare individual who, unlike the vast majority of others in the profession, lacks the formal educational training and degree. But where most or all employees in a particular job lack advanced education and instruction, the exemption does not apply. If a job does *not* require knowledge customarily acquired by an advanced educational degree – as for example when many employees in a position have no more than a high school diploma – then, regardless of the duties performed, the employee is not an exempt professional under the FLSA.

With these principles in mind, said the court, it is clear

that Young was not exempt. The PDS II position required no advanced educational training or instruction and, in fact, no PDS II had more than a high school education.

Young’s employer willfully violated the FLSA

An employer willfully violates the FLSA when it either knows or shows reckless disregard for the question of whether its conduct is prohibited. The effect of a willfulness finding is to extend the statute of limitations period from two to three years. Here, the question was whether Cooper Cameron acted in good faith when it classified Young as exempt. The Second Circuit affirmed that it did not.

The lower court found that the only reason Young was offered the PDS II position instead of the Mechanical Designer position was because Cooper Cameron wanted to avoid paying him overtime, and that Young – notwithstanding his title of PDS II – did the work of a nonexempt Mechanical Designer.

Young was originally considered for employment as a Mechanical Designer. Only after he rejected an offer did Cooper Cameron raise with him the PDS II position. At that point, there was little discussion of the PDS II’s duties because both parties understood that Young’s duties would be about the same as those of a Mechanical Designer. And for the entire time Young worked at Cooper Cameron, he did the work of a Mechanical Designer.

Even if the jobs were different said the court, what matters was whether *Young* did the work of a nonexempt Mechanical Designer, not whether PDS IIs *generally* did more advanced work than Mechanical Designers [*Young v. Cooper Cameron Corp.*, 586 F.3d 201 (2nd CA, 11-12-09)]. ■

Supreme Court Denies Review of Case Involving ‘Willful’ Failure to Remit Payroll Taxes

The U.S. Supreme Court has refused to hear the appeal of a case involving a nursing home operator convicted of the crime of “willfully” failing to collect or pay over more than \$20 million in taxes owed (IRC §7202) and sentenced to 30 months in prison [*U.S. v. Easterday*, No. 09-28 (U.S. Sup. Ct., 11-2-09)]. As a result, the decision of the Ninth Circuit Court

of Appeals will stand. That court rejected Easterday’s claim that his failure to pay was not willful because he lacked the financial ability to comply with his tax obligations, explaining that a taxpayer’s financial circumstances are not relevant to the determination of willfulness under §7202 (see [PAYROLL CURRENTLY, Issue No. 19, Vol. 16](#)). ■

Employer’s Medical Documentation Deadline Violated the FMLA

CallTech Communications, LLC, enforced employee discipline using an electronic point system that governed attendance and other performance-related issues. An employee was subject to termination if he or she accumulated six infraction points.

CallTech employee Stephanie Smith was approved for intermittent leave under the Family and Medical Leave Act (FMLA) because of chronic major depressive disorder and dysthymic disorder. Thereafter, she frequently came to work late, left work before her shift ended, and sometimes missed entire shifts.

Under CallTech’s attendance policy, an employee who did not come to work as scheduled automatically received a disciplinary infraction. When Smith was going to be late or miss a shift, she called an automated number that did not allow her to enter an explanation for her lateness or absence, so she verbally explained her absences to her supervisor.

CallTech’s attendance policy required employees on

intermittent FMLA leave to provide a physician’s note verifying that every instance of absence, lateness, or leaving work early was directly related to the employee’s medical condition on file with the company.

On May 28, 2006, Smith’s supervisor told her that she had 6.75 disciplinary infraction points. She was told that her employment would be terminated on May 31 if she did not reduce her infraction points below the threshold for termination by providing notes from her doctor that at least some of her absences were related to her medical condition. Smith stopped coming to work after May 31 and sued the company for interfering with her FMLA rights.

Documentation demand was unlawful

The court said that CallTech’s attendance policy, as applied to Smith, violated the FMLA. CallTech was entitled to medical documentation for Smith’s absences, even though she had been approved for intermittent FMLA leave in connection with her depression and had verbally informed her supervisor

that her absences were related to that condition. However, the company had to provide Smith with a reasonable amount of time to obtain the doctor's notes it required. Allowing Smith only three days to obtain the medical documentation for her absences was "unreasonable as a matter of law."

The fact that under CallTech's attendance policy Smith knew she was expected to provide a doctor's note for *all* instances of unplanned sick leave, whether FMLA-related or

not, did not excuse CallTech's conduct. An employer cannot deny FMLA leave because an employee fails to comply with the employer's internal procedures so long as the employee gives timely verbal or other notice. "Accordingly, any adverse employment action, e.g., termination, that is affected by such considerations is actionable under the FMLA" [*Smith v. CallTech Communications, LLC*, No. 2:07-cv-144, 2009 U.S. Dist. LEXIS 48518 (SD Ohio, 6-10-09)]. ■

Arson Investigators Could Be Paid Under FLSA Fire Protection Rules

Arson investigators employed by the city of Montgomery, Alabama, are trained in fire suppression, obtain emergency medical technician certification, receive training in fire investigation, and attend monthly fire suppression drills. They can be directed to engage in fire suppression activities by a superior officer or a fire commander at the scene of a fire.

On the other hand, arson investigators must also graduate from the Montgomery police academy, obtain certification as peace officers, and maintain that certification with continuing education. The majority of an arson investigator's time is spent doing investigative work, which is a law enforcement activity.

The Fair Labor Standards Act (FLSA) provides a limited overtime exemption for employees engaged in fire protection activities or law enforcement activities (29 USC §207(k); see *The Payroll Source*®, p. 2-55). Under 29 C.F.R. §553.230(c), employees engaged in fire protection activities must be given overtime pay for all time worked beyond 106 hours in each 14-day work period, but employees engaged in law enforcement activities must be given overtime pay for all time worked beyond 86 hours in each 14-day work period.

Here, Montgomery paid its arson investigators overtime based on the fire protection activities exemption, and the arson investigators sued to recover overtime compensation under the more favorable law enforcement activities exemption.

Analysis

The court explained that Congress amended the

FLSA in 1999 to define an employee engaged in "fire protection activities" as an employee who: (1) is trained in fire suppression, has the legal authority and responsibility to engage in fire suppression, and is employed by a fire department of a municipality, county, fire district, or state; and (2) is engaged in the prevention, control, and extinguishment of fires or response to emergency situations where life, property, or the environment is at risk (29 USC §203(y)).

Section 203(y) made pre-existing DOL regulations defining fire protection activities as well as other related regulations obsolete. Here, in a case of first impression, the court said that one of the regulations made obsolete by §203(y) is 29 C.F.R. §553.213(b), which provides that where employees perform both fire protection and law enforcement activities, the applicable overtime standard is the one that applies to the activity in which the employee spends the majority of work time during the work period. The regulation, said the court, is obsolete "because the new statutory definition has supplanted it."

Accordingly, the fact that the Montgomery arson investigators did not spend the majority of their time performing fire protection activities did not matter. They satisfied the definition of employees in fire protection activities under §203(y) and were therefore properly compensated [*Cremins v. City of Montgomery*, No. 2:08-cv-00546-MEF-WC, 2009 U.S. Dist. LEXIS 93897 (MD Ala., 10-7-09)]. ■

Cable Splicers Were Not Independent Contractors Under the FLSA

Driftwood Electrical Contractors, Inc., helped to restore BellSouth telecommunications lines in Mississippi damaged by Hurricane Katrina. To perform this work, Driftwood hired Jeff Bankston and Fred Cromwell as cable splicers. They received a fixed hourly wage for working 12 hours a day for 13 days followed by one day off.

Bankston and Cromwell reported to a BellSouth location every morning to receive their assignments, unless they were continuing jobs from the previous workday. They received prints describing the work to be performed and were instructed by BellSouth supervisors to follow certain general specifications.

The splicers supplied their own trucks, testing equipment, connection equipment, insulation equipment, and hand tools; BellSouth supplied materials such as closures and cables. The splicers paid for their vehicle liability insurance and employment taxes; Driftwood provided workers' compensation and liability insurance.

When Bankston and Cromwell sued to recover overtime pay

under the Fair Labor Standards Act (FLSA) for hours worked over 40 in a workweek, the Fifth Circuit Court of Appeals said that "as a matter of economic reality" they were dependent on Driftwood and BellSouth and not in business for themselves [*Cromwell v. Driftwood Electrical Contractors, Inc.*, No. 09-60212, 2009 U.S. App. LEXIS 22389 (5th CA, 10-12-09)].

WHAT THE LAW SAYS – Courts consider the following factors in deciding whether the "economic reality" of the relationship between a worker and an alleged employer indicates that the worker is an employee or independent contractor under the FLSA: (1) the degree of control that the alleged employer has over the manner in which the work is performed; (2) the relative investments of the worker and the alleged employer; (3) the degree to which the worker's opportunity for profit and loss is determined by the alleged employer; (4) the degree of skill and initiative required for the work; and (5) the permanency of the working relationship. These factors are not exclusive, and no single factor controls the determination.

Balance of factors showed employee status

Bankston and Cromwell controlled the details of their work, were not closely supervised, and were not trained by Driftwood and BellSouth. They invested substantial amounts in their trucks, equipment, and tools. Their work required a high level of skill. These facts pointed in favor of independent contractor status, but they were not enough, said the court, to establish that Bankston and Cromwell were in business for themselves.

The splicers worked full time exclusively for Driftwood and BellSouth for approximately 11 months. They did not have a “temporary, project-by-project, on-again-off-again relationship with their purported employers,” and the temporary nature of

their emergency restoration work did not count against employee status.

The permanency of the splicers’ work relationship during this time, along with the control Driftwood and BellSouth exercised over their schedule and pay, severely limited their opportunity for profit or loss. Bankston and Cromwell might not have been expressly prohibited from taking other jobs while working for Driftwood and BellSouth, but their work schedule effectively precluded significant extra work. Moreover, the fact that Driftwood and BellSouth provided Bankston and Cromwell with their work assignments limited their need to demonstrate initiative in performing their jobs. ■



STATE AND LOCAL NEWS

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Connecticut

Reporting requirement not affected by 14-day withholding threshold. Employers must report wages paid to a nonresident employee who works fewer than 14 days during a calendar year in Connecticut even though withholding is not required (see *PAYROLL CURRENTLY*, Issue No. 24, Vol. 17). Report on Form CT-941, *Connecticut Quarterly Reconciliation of Withholding*, and in Box 16 (State wages, tips, etc.) on federal Form W-2, *Wage and Tax Statement*, instructs the Department of Revenue Services [DRS, AN 2010 (3), 1-11-10].

Delaware

Electronic filing and payment system available. The Department of Revenue (DOR) now offers a web-based system that employers can use to file monthly, quarterly, and eighth-monthly withholding tax returns online and pay taxes electronically via the ACH debit method. The system is available at www.revenue.delaware.gov/services/online_svcs.shtml [DOR, News Release, 12-3-09].

Hawaii

State furlough days treated as state holidays. Furlough days at the Department of Taxation (DOT) are treated as state holidays. Therefore, any filing or payment that is due on a furlough day is not due until the next succeeding day that is not a Saturday, Sunday, furlough day, or legal holiday. A tax furlough calendar is available at www6.hawaii.gov/tax/documents/ATTACHMENTB.pdf [DOT, Announcement No. 2009-32, 11-23-09].

Michigan

Child support maximum withholding amount changed. Effective 12-28-09, the maximum amount that may be withheld from an employee’s wages for child support is 50 % of disposable earnings. Previously, the maximum withholding amount was determined under the federal Consumer Credit Protection Act (see *The Payroll Source*®, pp. 9-9 – 9-11) [S.B. 100, L. 2009].

Montana

Paycard use allowed. The Department of Labor and Industry (DOLI) has answered frequently asked questions regarding electronic wage payments at <http://erd.dli.mt.gov/laborstandard/documents/faqelectronicwagepay11-18-2009.pdf>. These FAQs include the DOLI’s new enforcement position on paycards. An employer may use a paycard to pay wages provided certain conditions are met, including that the employee consents and can access the full amount of his or her wages without incurring a fee in the initial withdrawal.

Nebraska

Independent contractor new hire reporting required. Effective 1-1-10, independent contractors must be reported as new hires to the Nebraska State Directory of New Hires. Employers must report only independent contractors that it contracts with on or after 1-1-10, within 20 days of the contract date [L.B. 288, L. 2009].

New York

MTA payroll tax guidance issued. The Department of Taxation and Finance (DTF) has issued guidance with regard to computing, reporting, and paying the new Metropolitan Commuter Transportation Mobility Tax (MCTMT; known as the MTA payroll tax because it is distributed to the Metropolitan Transportation Authority). The guide is available at www.nystax.gov/pdf/publications/mctmt/pub420.pdf [DTF, Publication 420, *Guide to the Metropolitan Commuter Transportation Mobility Tax*, 1-10].

Oklahoma

Payment of wages by electronic means allowed. The Oklahoma Attorney General has issued a formal opinion regarding the payment of wages by electronic means at www.ok.gov/odol/Electronic_Payment_of_Wages.html:

Direct deposit. An employer may require employees to use direct deposit for the payment of wages. However, the employer may not require that a certain bank be used. If the employer's policy only allows employees to receive direct deposit at a certain bank, then the employer may not require direct deposit and must offer the option of cash or check. Employees may not be charged a fee to receive wages by electronic means.

Paycards. An employer may not require the use of payroll debit cards. An employee may choose to use a payroll debit card, but it must be voluntary. Employees may not be charged a fee to receive wages by electronic means.

Electronic pay statements. Pay statements do not have to be written or printed. They can be in electronic form so long as the method of delivery places no burden on the employee in order to receive the statement. The form the delivery takes depends on the capability of the employee to receive it. E-mailing a pay statement is permissible so long as the employee provides an e-mail address. Merely placing the statement on a website where the employee has to retrieve it is not permissible [OAG Op. 09-31, 11-17-09].

New semiweekly depositor requirements introduced. Effective 3-1-10, every employer required to remit federal withholding taxes under the federal semiweekly deposit schedule must pay state withholding taxes on the same dates. For employers not using electronic funds transfer (EFT) for payments, a withholding return must be filed with each payment. For employers making payments by EFT, a return must be filed by the twentieth day of the month following the end of each monthly period. Also effective 3-1-10, employers subject to the semiweekly deposit requirements must file returns pursuant to the Tax Commission's electronic data interchange program [S.B. 318, L. 2009].

Oregon

New withholding tables anticipated. On 1-26-10, Ballot Measure 66 passed at a special election. For tax years 2009, 2010, and 2011, the tax rate increases to 10.8% (previously 9%) for single filers with taxable income over \$125,000 and joint filers with taxable income over \$250,000, and to 11% (previously 9%) for single filers with taxable income over \$250,000 and joint filers with taxable income over \$500,000. For tax years 2012 and beyond, the tax rate will decrease to 9.9% for single filers with taxable income over \$125,000 and joint filers with taxable income over \$250,000. The Department of Revenue will issue updated withholding tables and formulas on 3-1-10 (check www.oregon.gov/DOR/BUS/payroll_updates.shtml).

Wisconsin

Special withholding arrangement authorized following termination of tax reciprocity agreement with Minnesota. The Department of Revenue (DOR) has authorized a special withholding arrangement for employers of Wisconsin residents working in Minnesota, following the termination of the income tax reciprocity agreement by Minnesota. Wisconsin residents working in Minnesota are subject to Minnesota withholding on their wages. If the employer has nexus with Wisconsin, the employer would also be required to withhold Wisconsin income tax from the same wages. However, Wisconsin withholding will not be required under those circumstances. Find frequently asked questions regarding the termination of the reciprocity agreement at www.revenue.wi.gov/faqs/ise/mnrecipro.html [DOR, News for Tax Practitioners, 1-20-10].

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**Publisher,
Executive Director**
Dan Maddux

**Senior Director of
Publications and
Government Relations**
Michael P. O'Toole, Esq.

Managing Editor
Anne S. Lewis, Esq.

Editors
Laura Lough, Esq.
Edward Kowalski, Esq.

Inside Washington
Scott Mezistrano, CPP
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**Manager,
Art Department**
Jennifer Sanfilippo

Graphic Designer
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