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Rothman Gordon, P.C.
Attorneys At Law
310 Grant Street
Third Floor, Grant Building
Pittsburgh, PA 15219
(phone) 412.338.1100
(fax) 412.281.7304
www.rothmangordon.com

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Key provisions of the Small Business Jobs Act of 2010

While the recession may be declared over, many businesses are still trying to get back on their feet. On September 27, 2010, President Obama signed the Small Business Jobs and Credit Act of 2010. Here are some of the benefits small business owners can look to reap.

No tax on small business capital gains. Now is a good time to invest in small business. Qualified Small Business (QSB) stock that is acquired between September 27, 2010 and January 1, 2011 and held for at least five years is 100% exempt from capital gains and the Act eliminates the attributable AMT preference.

Increase of Section 179 Expensing and Expansion to Certain Real Property. Now is a good time to make investments in your business. Business owners may write off the cost of certain real property purchased for use in trade or business in lieu of recovering those costs over time through depreciation. The Act means that for 2010 and 2011, small businesses can immediately write off \$500,000 and the level of investments at which the write off phases out has been raised to \$2 million.

Extends the 50% bonus depreciation. By accelerating the rate at which capital expenditures are deducted, business owners can receive a tax cut this year. Congress had allowed certain capital expenditures made in 2008 and 2009 to be written off more quickly by allowing 50% depreciation for qualifying property purchased. The Act extends the 50% write off of depreciable property for 2010.

Self-employed can deduct health insurance costs. Before the passage of the Act, business owners could not deduct the cost of health insurance for themselves or their family members when calculating self-employment tax but paid a self-employment tax comparable to the Social Security tax paid on employee wages. For 2010 only, that restriction is removed.

No more extra paperwork for cell phone deductions. Cell phones have been removed from "Listed Property." Now cell phone costs can be deducted or depreciated like other business property.

Increase in entrepreneur start-up expenses deduction. Now is a good time to invest in a start-up company. The Act temporarily increases for this year from \$5,000 to \$10,000 the amount of start-up expenditures that can be deducted. The phase-out threshold is \$60,000.

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Violations to watch for concerning exempt employees

By Alan C. Blanco, Esquire and Andrew Horowitz

This is the final article in our series on the Fair Labor Standards Act (FLSA). In previous issues, we discussed an overview of the Act; nonexempt versus exempt employees; and violations to watch for concerning nonexempt employees. Today, we will focus on compensation requirements for maintaining the exemption for exempt employees.

Let's begin by recapping U.S. Department of Labor standards. According to the DOL, the FLSA requires that most employees in the United States be paid at least the federal minimum wage for all hours worked and overtime pay at time and one-half the regular rate of pay for all hours worked over 40 hours in a workweek.

However, Section 13(a)(1) of the FLSA provides an exemption from both minimum wage and overtime pay for employees employed as bona fide executive, administrative, professional and outside sales employees. Section 13(a)(1) and Section 13(a)(17) also exempt certain computer employees. To qualify for exemption, employees generally must meet certain tests regarding their job duties and be paid on a salary basis or fee basis at not less than \$455 per week. Job titles do not determine exempt status. In order for an exemption to apply, an employee's specific job duties and method of payment must meet all the requirements of the Department's regulations.

The remainder of this article focuses on some potential traps employers can fall into with how they pay exempt employees. The article assumes that the employees in question meet the applicable duties tests; in other words, these employees are performing duties which properly place them within the executive, administrative, professional or computer exemption. Making this assumption in no way diminishes the importance of the duties side of testing whether employees are properly exempt. Employees must both perform exempt duties and be paid on a salary or fee basis for the applicable exemptions to apply. One of the most common errors employers make is paying white collar employees on a salary basis with the belief that paying a salary alone makes any white collar employee exempt. Many employers have paid dearly for this mistake.

Generally, the payment options for exempting bona fide executive, administrative, professional, or exempt computer employees require payment on a salary or fee basis. The essence of payment on a salary basis is that the employee regularly receives a predetermined amount of compensation each pay period on a weekly, or less frequent, basis, which predetermined amount cannot be reduced because of variations in the quality or quantity of the employee's work. One court noted that payment on a salary basis was thought to identify executive, administrative, and professional personnel precisely because it indicated employees who were given discretion in managing their time and their activities and who were not answerable merely for the number of hours worked or the number of tasks accomplished.

Executive, administrative, professional, or exempt computer employees generally must be paid at not less than \$455 per week on a salary basis in order for the exemption to apply. (An

option for exempt computer employees is payment at an hourly rate of not less than \$27.63 per hour). Some DOL's guidance on the intricacies of payment on a salary basis is highlighted in the sidebar: Salary Basis Requirements and the Part 541 Exemptions under the FLSA, which accompanies this article.

Payment on a fee basis is an option which is consistent with maintaining the exempt status of executive, administrative, professional, or exempt computer employees. If the employee is paid an agreed sum for a single job, regardless of the time required for its completion, the employee will be considered to be paid on a "fee basis." The DOL explains that a fee payment is generally paid for a unique job, rather than for a series of jobs repeated a number of times and for which identical payments repeatedly are made. To determine whether the fee payment meets the minimum salary level requirement, the test is to consider the time worked on the job and determine whether the payment is at a rate that would amount to at least \$455 per week if the employee worked 40 hours. The DOL offers as an example an artist paid \$250 for a painting that takes 20 hours to complete. Payment meets the minimum requirement since the rate would yield \$500 if 40 hours were worked.

Payment on a fee basis is relatively unusual. Payment on a salary basis is a more common source of error, with the most common errors involving inappropriate reductions in salary. Here are some minefields:

Minefield #1: Pay Deductions for Absence. The employer should not make deductions from the pay of an exempt employee for absences caused by the employer or in the interest of the operating requirements of the business. Remember, the essence of pay on a salary basis is that the employee receives a predetermined amount of compensation each pay period which does not decrease with variations in the quality or quantity of the employee's work. Thus, an employee whose income is derived from commissions is not paid on a salary basis. (Employers may pay outside salespeople on a commission basis, provided the requirements for the outside sales exemption are met). Similarly, an employer who calls exempt employees and tells them to stay home the next day (without pay) because work is slow is reducing salary because of a variation in the quantity of work available; that practice is not consistent with payment on a salary basis.

A red flag for violation of the requirements of payment on a salary basis is reduction of an exempt salaried employees' pay for less than full day absences for personal reasons. Employers are permitted to reduce time from such an employee's accrued leave account, but when the employee runs out of leave, he or she must be paid full salary. Permissible reductions are summarized in the sidebar: Salary Basis Requirements and the Part 541 Exemptions under the FLSA. Most of these exceptions apply when an employee misses a day or more of work. For example, if an employee violates a safety rule of major significance, the employer can dock his pay as a penalty. Similarly, the employer may give an employee an unpaid suspension of a day or more for infractions of workplace conduct rules. Also, if an employee works partial weeks at the beginning or end of his tenure with the

employer, his pay for those weeks may be adjusted accordingly. Exempt employees do not need to be paid for any workweeks in which they perform no work.

Minefield #2: Furlough. In these difficult economic times, it has become common for employers to furlough employees during slow periods to reduce costs while avoiding layoffs. The FLSA permits this with exempt employees; however, if an exempt employee performs ANY work in a week, the employee must receive full salary for that week. The safest method of using furloughs is to only utilize entire week increments. Employers should make sure that there is absolutely no working (including checking company email and voicemail) while on furlough because this could destroy exempt status.

Some employees may want to use their vacation or PTO during a furlough. It is advisable to make this voluntary. State and local laws may restrict mandating use of vacation or PTO time, and if an employee only uses or has enough time accrued to cover part of a work week, the employer may have to pay for the entire week.

Minefield #3: Shortened Workweeks. Employers sometimes also shorten employee workweeks and reduce pay accordingly. This can be very tricky and should not be undertaken without a thorough review by counsel including an up-to-date review of the then current case law, and even in those circumstances there could be risk. The problem is that shortening a workweek because of lack of work comes very close to reducing salary because of the operating requirements of the business. There is a handful of DOL Opinion Letters on the subject and reducing the work week with a commensurate reduction in pay may be permitted so long as (A) the employee's salary remains at least \$455 per week and (B) it is a bona-fide reduction not intended to circumvent the salary basis requirement. The bona-fide reduction requirement generally means that employee work hours cannot be adjusted on a day-to-day or week-to-week basis according to the employer's business needs.

How employers can protect their employees' exempt status

The stakes for employers are high. If an employer violates the rules with respect to a single exempt employee, not only will that employee lose his exempt status, but other employees can be affected as well. Fortunately, there are steps employers can take to prevent violations and minimize the impact of violations when they occur. First, employers should clearly communicate a policy that prohibits improper pay deductions and offers a mechanism for employees to report violations internally. When violations do occur, the employer can minimize exposure by reimbursing the employee for the improper deduction and making a good faith commitment to comply with the FLSA in the future.



Alan Blanco's practice is exclusively in the field of employment law, representing primarily individuals, including executives and professionals, as well as unions and closely-held businesses with regard to employment matters. Alan can be reached at (412) 338-1125 or acblanco@rothmangordon.com.



Andrew Horowitz is a law clerk at Rothman Gordon. He is currently attending the University of Pittsburgh School of Law.

Salary Basis Requirements and the Part 541 Exemptions under the FLSA

To qualify for exemption, employees generally must be paid at not less than \$455 per week on a salary basis. These salary requirements do not apply to outside sales employees, teachers, and employees practicing law or medicine. Exempt computer employees may be paid at least \$455 on a salary basis or on an hourly basis at a rate not less than \$27.63 an hour.

Being paid on a "salary basis" means an employee regularly receives a predetermined amount of compensation each pay period on a weekly, or less frequent, basis. The predetermined amount cannot be reduced because of variations in the quality or quantity of the employee's work. Subject to exceptions listed below, an exempt employee must receive the full salary for any week in which the employee performs any work, regardless of the number of days or hours worked. Exempt employees do not need to be paid for any workweek in which they perform no work. If the employer makes deductions from an employee's predetermined salary, i.e., because of the operating requirements of the business, that employee is not paid on a "salary basis." If the employee is ready, willing and able to work, deductions may not be made for time when work is not available.

Circumstances in Which the Employer May Make Deductions from Pay

Deductions from pay are permissible when an exempt employee: is absent from work for one or more full days for personal reasons other than sickness or disability; for absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for salary lost due to illness; to offset amounts employees receive as jury or witness fees, or for military pay; for penalties imposed in good faith for infractions of safety rules of major significance; or for unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions. Also, an employer is not required to pay the full salary in the initial or terminal week of employment, or for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act.

Effect of Improper Deductions from Salary

The employer will lose the exemption if it has an "actual practice" of making improper deductions from salary. Factors to consider when determining whether an employer has an actual practice of making improper deductions include, but are not limited to: the number of improper deductions, particularly as compared to the number of employee infractions warranting deductions; the time period during which the employer made improper deductions; the number and geographic location of both the employees whose salary was improperly reduced and the managers responsible; and whether the employer has a clearly communicated policy permitting or prohibiting improper deductions. If an "actual practice" is found, the exemption is lost during the time period of the deductions for employees in the same job classification working for the same managers responsible for the improper deductions.

Isolated or inadvertent improper deductions will not result in loss of the exemption if the employer reimburses the employee for the improper deductions.

Safe Harbor

If an employer (1) has a clearly communicated policy prohibiting improper deductions which includes a complaint mechanism, (2) reimburses employees for any improper deductions, and (3) makes a good faith commitment to comply in the future, the employer will not lose the exemption for any employees unless the employer willfully violates the policy by continuing the improper deductions after receiving employee complaints.

General business credit is carried back five years.

Unused business credits were able to be carried back to the previous year and the remaining amount carried forward 20 years. The Act extends the carry back five years, for sole proprietorships, partnerships and non-publicly traded corporations with \$50 million or less in average gross revenues for the prior three years.

Levels the tax penalty playing field. Section 6707A of the Internal Revenue Code had a fixed dollar amount penalty for failing to report certain tax transactions. Small business advocates argued the fixed dollar amount disproportionately penalized small businesses, who were paying the same penalty as larger businesses with larger transactions. The Act changes the penalty for failure to disclose a reportable transaction to 75% of the tax benefits received.

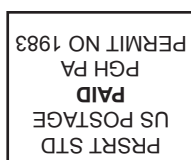
In addition to tax benefits, the Small Business Jobs and Credit Act also aims to assist small business with changes to SBA programs and loans. It increases the maximum loan size for SBA loan programs, including:

- Increases 7(a) and 504 loan limits from \$2 million to \$5 million. Borrow fees eliminated through December 31, 2010.

- Increases 504 manufacturing related loan limits from \$4 million to \$5.5 million. Borrow fees eliminated through December 31, 2010.
- Increases microloan limits to \$50,000.
- Temporarily increases SBA Express loans from \$350,000 to \$1 million.

A Small Business Lending Fund of \$30 billion has been established by providing capital to smaller banks with incentives to increase lending. The Act also created a State Small Business Credit Initiative (SSBCI), which set aside \$1.5 billion for states to support small business lending programs. Finally, the rules for S Corp holding period have been relaxed. Previously, a C corporation converting to an S corporation had to hold the assets for 10 years or pay the max 35% corporate tax rate on built in gains. That period was shortened to seven years for 2009 and 2010 and under the Act, is now five years beginning in 2011.

If you have questions on how the Small Business Jobs and Credit Act may affect your business or how you can take advantage of these changes, please contact your Rothman Gordon attorney.



Rothman Gordon P.C.
 310 Grant Street
 Third Floor, Grant Building
 Pittsburgh, PA 15219

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