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Employment Issues, Selected Chapters from the Accountant's Business Manual

William H. Behrenfeld

Andrew R. Biebl

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AICPA

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- Employment Regulations
- Workers' Compensation
- Unemployment Insurance
- Employee Retirement & Deferred Compensation Plans
- Social Security
- Hiring Foreign Nationals

AICPA
American Institute of Certified Public Accountants

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EMPLOYMENT ISSUES

Prepared for the AICPA by

William H. Behrenfeld, JD, LLM, CPA
Sarasota, Florida
Andrew R. Biebl, CPA
Biebl, Ranweiler, & Co., Chtd.
New Ulm, Minnesota

CONTRIBUTORS

Cathleen L. Bang, JD
Craig E. Behrenfeld
Julie L. Bursik, JD
Richard J. Christiansen, CPA
Francis D. Collins, JD
Christopher W. Dungan, CPA, PhD, JD
Christopher R. Malburg, CPA, MBA
Robert B. Nadel, CPA, JD
Robert J. Ranweiler, CPA
Robert J. Seifert, CPA
Dean L. Surkin, JD, LLM
Eric D. Satre

1211 Avenue of the Americas, New York, N.Y. 10036-8775
1 2 3 4 5 6 7 8 9 PA 8 9

PREFACE

The Accountant's Business Manual, originally published in 1987, is a twenty-two chapter looseleaf reference work semi-annually updated and designed to provide quick access to concise summaries of theory and practice in a variety of business topics. The material in *The Accountant's Business Manual* constitutes a first reference source either for a quick answer or for topical overview leading to in-depth research or expert consultation. It is available from the AICPA order department: 1-800-334-6961; 1-800-248-0445 (N.Y.).

This volume on Employment Issues collects five chapters from *The Accountant's Business Manual* that deal with hiring, payroll, and employee benefits administrative matters. During the past decade, events took place that place greater emphasis on general management's understanding of human resources issues including equal opportunity laws, occupational health risks, environmental hazards, restrictions on alien employment and increasingly complex retirement benefit administration. The chapters reprinted here outline important information essential for business owners and their advisors:

Employment Regulations. This chapter covers federal wage and hour regulations, labor relations, payroll withholding requirements, discrimination issues, and certain post-employment matters. The appendixes list state labor, civil rights, and equal opportunity agencies' addresses and telephone numbers for further inquiry into those employment matters covered by state regulations.

Workers' Compensation. This chapter covers federal regulation with regard to workers' compensation and surveys the system of state laws that provide medical compensation and other benefits for injured employees.

Unemployment Insurance. This chapter surveys the Federal Unemployment Tax Act including compliance, reporting, and deposit requirements and interaction between FUTA and state laws. The appendix lists addresses and telephone numbers of state unemployment insurance agencies.

Employee Retirement and Deferred Compensation Plans. In the wake of the Tax Reform Act of 1986, retirement benefit plans became an area of increasing interest to CPAs and business owners. A substantial portion of the 1986 law (and subsequent corrections) called for sweeping changes in plan setups. This chapter defines the various plans and their qualification, funding, accounting, disclosure, and filing requirements. It also discusses tax advantaged retirement vehicles and plan mergers and terminations.

Social Security. This is a complete survey of the system's retirement, survivors', disability, and medicare benefits including who can receive them, when and how to apply for benefits, and how to calculate approximate benefit amounts. The chapter includes employer contribution responsibilities and benefit application appeals.

Hiring Foreign Nationals. This chapter surveys the regulations and procedures of the Immigration and Naturalization Service to be observed for obtaining visas and labor certificates when recruiting and hiring foreign nationals and arranging for entry and retention of intracompany transfers. It includes application for visas, immigration limits, employment classifications, application for labor certificates and review of adverse decisions.

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EMPLOYMENT REGULATIONS

EMPLOYMENT REGULATIONS

1. INTRODUCTION

Employment is regulated by the federal government, by state and local governments, by collective bargaining agreements, and by written or oral employment contracts. This chapter covers wages and hours, labor relations, discrimination issues, and certain post-employment issues. Occupational health and safety is covered in the chapter on workers' compensation, and employee benefits and U.S. immigration laws are also covered in other chapters of the manual.

These employment regulations exist to protect employees with regard to such items as wages and hours, unlawful discrimination, and hiring policies.

2. SOURCES

Employment regulation stems from several sources. Federal statutes, state statutes, local ordinances, collective bargaining agreements, common law, and private employment contracts all interact to govern the employer/employee relationship.

Even though federal statutes may not exist in a given area, state and local statutes, along with collective bargaining agreements, should be closely reviewed for possible applicability.

2.1 Federal Statutes and Regulations

The federal government draws its authority to regulate employment from such laws as the Fair Labor Standards Act (FLSA), the Civil Rights Act of 1964 (specifically Title VII), the Age Discrimination in Employment Act of 1967, the 1974 Employee Retirement Income Security Act (ERISA), the 1986 Comprehensive Budget Reconciliation Act (COBRA), the Immigration and Naturalization Act of 1986, and the National Labor Relations Act.

The agencies authorized by Congress to regulate in this area are

— The Department of Labor (DOL).

— The Equal Employment Opportunity Commission (EEOC).

— The National Labor Relations Board (NLRB).

2.2 State and Local Statutes and Regulations

States and local governments may regulate in areas that have not been preempted by Congress. This means states and local governments may and do regulate in areas not regulated by Congress or where Congress does not expressly or by implication prevent it.

Sources of state regulation can be found in state statutes and administrative rules and regulations. This chapter summarizes *sources* of information on each state and describes general circumstances in states because it would not be practical to cover each state in detail. A listing of the state labor agencies is found at the end of this chapter; to obtain more specific statutory and regulatory information, apply to these sources.

2.3 Common Law

Because many areas of employment law have been heavily contested, both federal and state statutory laws have been interpreted and modified by the courts. Also, labor and payroll management guides such as those published by Commerce Clearing House and Prentice-Hall provide detailed state-by-state information as well (see references to the chapter). Under our common-law system, court-made law is another source of regulation.

2.4 Collective Bargaining Agreements

Collective bargaining agreements, when negotiated, provide a source of regulation for the specific employment relationship mandated by the agreement. Such agreements are valid and enforceable, assuming their provisions are legal and reasonable.

2.5 Written Employment Agreements

Where written employment agreements exist, they are a source of regulation for the specific employment relationships covered by the agreements. As long as the agreements are not illegal or unconscionable, they are valid and enforceable.

3. DEFINITIONS

The following definitions apply throughout this chapter. Different statutes tend to define the terms differently, so the terms must be considered in relation to specific statutes.

Employee. Any individual who performs services at the direction and control of an employer, both as to what shall be done and how it shall be done. An employer has the right to hire and fire an employee and also furnishes the tools and a place to work.

Independent contractor. Persons in business for themselves who are not under the direct supervision of another employee.

Workweek. A fixed and regular recurring period of 168 hours—seven consecutive 24-hour periods—that may start on any day of the week. Some collective bargaining agreements define a workweek to be less than seven days.

Holiday. A day customarily observed in the community in celebration of some historical or religious occasion.

Pay period. Period of service for which a payment of wages is ordinarily made to an employee. Each state governs the length of pay periods.

Vacation. A period of rest from work normally for a specific time frame, normally enjoyed with recreational activities.

Leave. A period for which permission to be absent from work has been granted.

3.1 Independent Contractor or Employee

An employer who erroneously categorizes an employee as an independent contractor may be liable for failure to pay unemployment insurance contributions, minimum wages, overtime, or social security, and for failure to withhold income tax. Additionally, employees who have been erroneously classified as independent contractors are covered by the National Labor Relations Act, and, if they are wrongfully discharged, the employer may be held liable for reinstatement of the discharged employee with back pay and restoration of lost benefits.

Statutes, such as the National Labor Relations Act and the Fair Labor Standards Act, do not provide a uniform definition of *independent contractor*. Various administrative agencies and the courts have not formulated one uniform definition, but instead look at the specific facts of each case and the purpose of each law in determining whether a worker is an independent contractor. Because of this, an individual who is considered an independent contractor, for purposes of unemployment insurance, may be determined to be an employee under the Fair Labor Standards Act.

Under common law, an employer–employee relationship generally is determined to exist when an employer has the right to control and direct the worker, not only in terms of what needs to be accomplished but also with respect to details and the means by which the result is accomplished. Stated differently, an employee is subject to the will and control of the employer not only in regard to what shall be done, but also *how* it shall be done. As long as the employer has the right to direct and control the manner in which the services are performed, an employer–employee relationship is deemed to exist.

Historically, the courts have also looked at other factors beyond the single determinative issue of control. The courts have found that other major factors that characterize an employer-employee relationship include the fact that the individual has the same wages, hours, or working conditions as other employees, and that the individual is subject to the same personnel policies as other employees, or that the employer furnishes the employee with tools or a place to work as he or she similarly furnishes to other employees.

Conversely, if a person exercises control or direction merely with respect to what is to be accomplished and not to the means and methods for accomplishing the result, an individual working with that person is normally deemed to be an independent contractor. Examples include construction contractors, lawyers and accountants engaged in the pursuit of an independent trade or business, and other similar professional trades or businesses.

An individual's status is determined on a case-by-case basis, and requires an examination of all the factors surrounding a particular working relationship. For the most part, the courts have looked at the "right to control," both in terms of the result to be accomplished and the manner and means by which the result is achieved.

4. FEDERAL WAGE AND HOUR REQUIREMENTS

4.1 Covered vs. Exempt Employees

All employees of certain enterprises having workers engaged in interstate commerce, producing goods for interstate commerce, or handling, selling, or otherwise working on goods or materials that have been moved in or produced for such commerce by any person are covered by the FLSA.

A covered enterprise is the group of related activities performed through unified operation or common control by any person or persons for a common business purpose and is

- Composed exclusively of one or more retail or service establishments (as defined in the FLSA) whose annual gross volume of sales or business is not less than $362,500 since January 1, 1982.
- Any other type of enterprise having an annual gross volume of sales or business of not less than $250,000.

— Engaged in the operation of a hospital; an institution primarily engaged in the care of the sick, the aged, the mentally ill or defective who reside on the premises; a school for mentally or physcially handicapped or gifted children; a preschool, elementary or secondary school; or an institution of higher education (regardless of whether or not such hospital, institution, or school is public or private or operated for profit or not-for-profit).

— Engaged in the business of construction or reconstruction.

— Engaged in laundering or cleaning of clothing or fabrics.

Some employees are specifically exempted from the requirements of the Fair Labor Standards Act. As a basic rule, bona-fide executive, administrative, and professional employees (including academic administrative personnel and teachers) and outside salespeople are exempt from the minimum wage and overtime requirements if they meet the tests set forth for each category.

Whether employees are exempt depends on

— Their duties and responsibilities.

— The salary paid (except in the case of doctors, lawyers, teachers, and outside salespeople).

The following partial lists represent employees who are fully or partially exempt from minimum wage, equal pay, and overtime pay requirements of the FLSA. A complete listing can be found in payroll management guides such as those published by Commerce Clearing House (CCH) and Prentice-Hall (see references to the chapter).

— Fully exempt from minimum wage, equal pay, and overtime pay:

Executive, administrative, or professional employees, including teachers, who meet minimum salary levels
Outside salespersons
Employees of amusement or recreational establishments that have seasonal peaks
Agricultural employees (see a payroll guide for details)

— Fully exempt from only the overtime requirements:

Employees of motor carriers subject to regulation by the secretary of transportation
Seamen
Agricultural employees
Taxicab drivers
Household domestic employees

— Partially exempt from overtime pay requirements:

Commissioned employees of retail or service establishments
Private hospital employees
Employees of hotels, motels, or restaurants

4.2 Minimum Wage Requirements

The minimum wage for federal purposes for agricultural and nonagricultural employees since January 1, 1981, is $3.35 per hour. State law also covers minimum wage and overtime provisions. The FLSA prevails over less beneficial state laws where both cover the same employees. Where requirements fixed by state law are higher than those under the FLSA, state law prevails.

Employees can be paid on an hourly, salary, monthly, piecework, or any other basis as long as the minimum hourly requirement is met. Calculations and requirements of the minimum hourly rate are as follows:

— A week in which the minimum rate is underpaid cannot be averaged with a week in which it is overpaid to satisfy the minimum requirement.

— Employees hired solely on the hourly rate *must* be paid at least the minimum rate.

— A fixed weekly salary divided by the number of hours worked must equal or exceed the minimum rate.

— Fixed monthly salaries can be converted into a weekly equivalent by multiplying the monthly salary by 12, then dividing by 52.

— Wages paid on a piece-rate basis meet the minimum requirements if the average hourly earnings for the workweek equal or exceed the minimum rate.

4.3 Overtime Pay

Generally, overtime pay must be paid on hours over forty worked in a workweek. The overtime pay must be one and one-half times the employee's regular hourly rate. The *regular hourly rate* is normally defined to be the average rate paid for hours worked during the week. It is the employee's total weekly compensation, less exclusions provided for in the FLSA, divided by total weekly hours worked. Calculations and requirements on overtime pay are these:

— The overtime pay is figured on a workweek basis whether the employee is paid on a daily, weekly, biweekly, monthly, or piecework basis.

— Each workweek stands alone. Overtime worked in one week may not be offset against nonovertime hours worked in another week.

— The FLSA contains no provision that requires the employer to pay an employee overtime for hours worked in excess of eight hours per day or for work on holidays, Saturdays, or Sundays, although some state and local statutes contain such provisions.

— An employer's order prohibiting overtime does not relieve the employer of the responsibility to pay overtime, if the employee is permitted to work.

— Overtime does not need to be paid weekly. It can be paid on the normal payday.

4.3.1 Overtime computations

Following are examples of computing overtime.

Hourly rate (regular pay rate for an employee paid by the hour). If more than forty hours are worked, at least one and one-half times the regular rate for each hour over forty is due, where regular rate is defined per paragraph one of section 4.3, above.

> *Example.* An employee paid $3.80 an hour works 44 hours in a workweek. The employee is entitled to at least one and one-half times $3.80, or $5.70, for each hour over forty. Pay for the week would be $152 for the first forty hours, plus $22.80 for the four hours of overtime—a total of $174.80.

Piece rate. The regular rate of pay for an employee paid on a piecework basis is obtained by dividing the total weekly earnings by the total number of hours worked in the same week. The employee is entitled to an additional one-half times this regular rate for each hour over forty besides the full piecework earnings.

> *Example.* An employee paid on a piecework basis works forty-five hours in a week and earns $162. The regular pay rate for this week is $162 divided by forty-five, or $3.60 an hour. In addition to the straight-time pay, the employee is entitled to $1.80 (one-half the regular rate) for each hour over forty.

Time and a half. Another way to compensate a pieceworker for overtime, if agreed to before the work is performed, is to pay one and one-half times the piece rate for each piece produced during overtime hours. The piece rate must then be the one actually paid during non-overtime hours and must be enough to yield at least the minimum wage per hour.

4.4 Amounts Treated as Wages for Agricultural Employees

Although most agricultural labor is considered covered employment under the Federal Insurance Contribution Act (FICA), only cash payments constitute wages for purposes of the FICA and only if

— The cash remuneration paid during the year is $150 or more or the employer's total payroll is $2,500 or more for the year and any cash wages were paid.

— The employee works for the employer on twenty or more days during the year.

Cash includes checks and other monetary forms of exchange, but it does not include noncash items such as lodging, food, clothing, or payment of other goods or commodities. Noncash payments for agricultural employees are not subject to FICA, federal, or state tax withholding or unemployment taxes.

4.5 Tipped Employees

Wages paid to a tipped employee are deemed to be increased by up to 40 percent of the applicable statutory minimum wage rate and not more than the actual tips received by the employee. In paying the wages of a tipped employee, the employer is allowed to credit up to 40 percent of the employee's statutory minimum wage as coming from tips. Each state sets its own maximum tip credit.

Example. Assume the statutory minimum wage is $3.35. The employer is allowed to pay a tipped employee $2.01 per hour (3.35 − (3.35 × .40)) provided that the employee actually received tips equal to or in excess of the tip credit.

To qualify as a tipped employee, the employee must be engaged in an occupation in which it is customary to receive more than $30 per month in tips.

4.6 Holiday Pay

Employers are not required by the FLSA to pay employees who do not work holidays or to pay at a premium rate for those who do work on holidays.

4.7 Vacation and Sick Pay

Employers are not required by the FLSA to give employees vacations, paid or otherwise, or to pay sick pay.

4.8 Rest Periods and Coffee Breaks

The FLSA does not require that employees be given rest or meal periods or coffee breaks. However, if rest periods and coffee breaks are given, governmental enforcement agents require them to be counted as hours worked if they last twenty minutes or less.

4.9 Child Labor Laws

The FLSA child labor provisions protect children who are employed. The provisions protect the educational opportunities of minors and prohibit their employment in jobs under conditions detrimental to their health or well-being. The Secretary of Labor provides lists of hazardous occupations for both farm and nonfarm jobs, in which minors below specified ages may not be employed.

Regulations governing youth employment in farm versus nonfarm jobs differ somewhat. A complete list of ages and acceptable work may be obtained by contacting

U.S. Department of Labor
Employment Standards Administration
Wage and Hour Division

Minors of any age may be employed by their parents at any time in any occupation on a farm owned and operated by their parents, although many state statutes exist to provide more restrictive regulations. Such state statutes should be referred to for specifics.

4.10 Employer's Records

Every employer subject to the provisions of the FLSA must maintain records on its employees and their wages, hours, and pay. This is true even with respect to exempt employees in determining whether the conditions for exemption are satisfied.

4.10.1 Employee information

The records for each covered employee must include the following:

— Full name

— Home address

— Date of birth if employee is younger than nineteen
— Sex and occupation
— Time and day on which the employee's workweek begins
— Regular hourly pay rate, the basis on which wages are paid, and regular rate exclusions
— Hours worked each workday and each workweek
— Total daily or weekly straight-time wages
— Total overtime excess compensation for the workweek
— Total additions to or deductions from wages paid each pay period
— Total wages paid each pay period
— Date of payment and the pay period covered
— Retroactive wage payment under government supervision
— The basis for payment of any wages differential to employees of the opposite sex in the same establishment

4.10.2 Statement of deductions

Some states require that employees be given a statement of deductions for each wage payment. Other states require that such information be given employees at stipulated intervals. A complete list of requirements by state can be found in a payroll managment guide such as those published by Commerce Clearing House (CCH) or Prentice-Hall (see references to this chapter).

4.10.3 Form of records and their retention

There are no specific guidelines as to the particular form that the employer's records must follow. However, the records will be considered inadequate if the specified information must be computed from scattered, unrelated, or illegible sources.

Most of the employer's records on an employee's wages and hours must be retained for three years, although it is recommended that retention be for a longer period, normally five years. There is significant disagreement about the length of time to retain records beyond that required by law.

4.10.4 Timing of wage payments

Each state governs the required frequency with which wage payments must be made. A payroll management guide such as those published by Commerce Clearing House or Prentice-Hall contains details (see references to this chapter).

4.11 Penalties

Any person found to willfully violate the Fair Labor Standards Act may be subject to a fine up to $10,000 or imprisonment up to six months.

Employers may be subject to civil liability to employees of unpaid minimum wages or overtime pay plus an equal amount as liquidated damages as well as attorneys' fees and costs, if a willful violation occurs.

If an employer is found to have discriminated against an employee for filing a complaint under this statute, the employer may also be subject to additional liability to that employee as a court may deem appropriate.

4.12 Payroll Deductions

Payroll deductions fall into seven categories:

1. Deductions to cover the cost of furnishing board, lodging, and other facilities to employees.
2. Deductions for other items such as tools and uniforms that are not regarded as facilities.
3. Social security tax and other deductions required by law.
4. Reductions in a fixed salary paid for a fixed workweek in weeks when the employee fails to work the full schedule.
5. Deductions for disciplinary reasons.
6. Garnishment. If an employer is required under court order to make payment to an employee's creditor, the payments are equivalent to payment to the employee. The amount withheld from a wage payment may not exceed restrictions imposed by the federal garnishment law. The wage garnishment law also prohibits the firing of an employee whose pay is garnished for the payment of a single debt.
7. Other deductions authorized by the employee in writing and permitted by law, such as union dues.

4.13 Handicapped Workers

Special reduced minimum wage rates are allowed under the FLSA for people whose earning capability is impaired due to age, physical or mental deficiency, or injury. A certificate authorizing employment at a lower rate must be obtained from the authorized regional representative of the federal wage and hour division. The following rules apply to these certificates:

— Applications must be made on an official form signed by the handicapped worker and the employer.

— Certificates remain in effect no longer than twelve months.
— Applications for renewal will be reviewed by the administrator's representative.
— Descriptions of alleged handicaps must be detailed.
— A medical certificate is required when the handicap is not clearly obvious.
— The disability must be a specific handicap to the proposed employment.

4.14 Termination

4.14.1 Termination pay

Dismissal payments and severance pay are any payments made by an employer on account of the involuntary separation of an employee from the service of the employer. These payments are subject to FICA, income tax withholding, and unemployment tax.

4.14.2 Final wage payment

Each state governs the time within which a final wage payment must be made to a terminated employee.

4.14.3 Form W-2

Upon termination, employees may request that their Form W-2 be issued to them. The employer is required to furnish the form within thirty days of the request or within thirty days after the last payment of wages, whichever is later.

4.15 Leaves of Absence

4.15.1 Time off to vote

Many states have laws that allow employees to take time off to vote. Although state laws vary, a general pattern exists. Ordinarily, an employee who is entitled to vote may leave work for a specified time without penalty or deduction from wages. The employer designates the length of the absence, although minimum time periods may be imposed by state law.

4.15.2 Military leave

The FLSA does not provide specific guidelines with regard to payment of wages during military leave. If an employee is on temporary leave from the job to serve in a state National Guard unit and the employer pays the employee the difference between the regular salary and the amount received from the state, the difference is considered wages and is subject to withholding.

4.15.3 Disability leave

The FLSA does not specify guidelines regarding disability leave. Company policy governs the length of any disability leave and other specifications. Many companies address disability leaves through funding provided by short-term and long-term disability insurance programs.

Federal statute specifies that sex discrimination includes discrimination on the basis of pregnancy, and that pregnant workers must be treated similarly to employees affected by other medical conditions. Pregnant workers have a qualified right to reinstatement of employment, and equal employment opportunity assures that pregnant workers will not lose their jobs on account of pregnancy. Many states guarantee pregnant women a certain number of pregnancy disability leaves in a manner similar to other disability leaves.

4.15.4 Jury leave

Under the Jury System Improvement Act of 1978 employers are prohibited from discharging, threatening to discharge, intimidating, or coercing any permanent employee as a result of that employee's jury duty service.

Employers who violate this act

— Are liable for lost wages due to the employee.

— May be forced to provide other appropriate relief such as reinstatement of an employee discharged because of the employee's jury leave.

— Are subject to a civil penalty of up to $1,000 for each violation to each employee.

4.15.5 Parental leave

The FSLA does not specify guidelines regarding parental leave. Many companies now offer a parental leave, to either parent, after the birth of a child and subject to approval of the company.

4.16 Family Employment

The employment of family members is subject to special rules.

Income tax withholding. No statutory exclusion is granted from the withholding of income tax from wages paid between family members, other than for agricultural employees.

FICA tax. Certain types of family employment are excluded from the withholding of FICA tax:

— Work performed by a child under nineteen years of age employed by a parent. This exemption ceases on the child's nineteenth birthday. (See section 7.4 of the Social Security chapter.)

The family service exception does not apply to work performed for a corporation where services are being performed by a child. The same is true for partnerships unless the employee is a child of any of the partners.

Federal unemployment tax. Services performed by an individual for a child or spouse and services performed by a child under the age of twenty-one in the employ of a parent are not subject to federal unemployment tax. (See section 3.8 of the Unemployment Insurance chapter.)

Special reduced minimum wage. Services performed by a minor under special certification during the school year in the health care industry may qualify for a reduced minimum wage.

5. DISCRIMINATION

5.1 Definition

Employment discrimination is the failure to apply similar terms and conditions of employment to all persons equally where no reasonable distinction can be found between those favored and those not favored.

5.2 Federal Legislation

Federal statutes prohibit discrimination in employment against those individuals who belong to a protected class: race, color, religion, sex, national origin, or age. For government contractors, discrimination is also prohibited for physical and mental handicap and against veterans.

5.2.1 Prohibited actions

These statutes specifically prohibit discrimination against any member of a protected class in any aspect of employment, including hiring, promotion, compensation, employee benefits, and termination. They also cover limiting, segregating, or classifying employees or applicants for employment in any manner that would deprive or tend to deprive any member of a protected class of employment opportunities or otherwise adversely affect that individual's employment status.

Employees who feel they have been discriminated against can obtain relief under provisions of the federal Equal Employment Opportunity Act and various state and local statutes.

5.2.2 Sexual harassment

The Civil Rights Act prohibits sexual harassment on the job. Sexual advances, verbal and physical, are considered sexual harassment when

— Submission to the advance is made either explicitly or implicitly a term of employment.

— Submission to or rejection of the advance is used as a basis for employment decisions.

— The advances substantially interfere with the individual's work performance or make the working environment intimidating, hostile, or offensive.

Penalties include injunctive relief, reinstatement or rehiring (with or without back pay), or any other equitable relief a court deems appropriate (including attorneys' fees).

5.2.3 Employer's obligations

An employer should have a policy stating clearly and concisely that discrimination and sexual harassment in the workplace is prohibited. In conjunction with these policies, there should also be a mechanism in place that will promptly and effectively permit an employee to raise a complaint with responsible management and require management to investigate and respond to complaints about discrimination and sexual harassment.

Two primary reasons employers should have both a policy and a procedure are that

— Complaints may be resolved before expensive governmental investigation and litigation.

— Employers may not be subject to liability if an employee does establish discrimination in the workplace, but failed to report it.

5.3 Age Discrimination in Employment Act (ADEA)

Employers are prohibited from discriminating against any individual because of that individual's age. Since the coverage of this law is under the Commerce Clause of the U.S. Constitution, only employers who are engaged in an industry in interstate commerce are affected. The purpose of the age discrimination law is to encourage the hiring of individuals based on ability rather than age. Many states also have statutes prohibiting discrimination based on age.

Employer coverage. Employers covered by ADEA must

— Be engaged in industry affecting commerce.

— Employ twenty or more workers for each working day in each of twenty or more weeks in the current or preceding calendar year.

Employee coverage. Generally, the age discrimination law covers employees over forty years of age.

Enforcement. The Age Discrimination Employment Act is enforced under the Fair Labor Standards Act by the Equal Employment Opportunity Commission (EEOC). Enforcement is obtained through individual employee suits and collective actions by employees.

5.4 State Antidiscrimination Laws

Appendixes at the end of this chapter summarize the respective state agencies in the area of civil rights and equal employment opportunity.

5.5 Comparable Worth

The Equal Pay Act of 1963 requires that workers receive equal pay for similar jobs, regardless of the sex of the individual employed. The objective is to prevent wage discrimination in the workplace based on gender.

Comparable worth addresses the difference in compensation that cannot be accounted for except by the individual's sex. Wages should be based on the worth of the work, not on the sex of the person doing the work. To conform to comparable worth guidelines, major studies are frequently required to determine the worth of work.

5.6 Affirmative Action

Affirmative action is the attempt to systematically dismantle discrimination against protected classes. Its proponents believe that affirmative action is one of the few effective methods to resolve discrimination.

A statement of affirmative action is provided by many companies, and, under provisions of the Equal Employment Opportunity Act, government contractors and others must issue and follow affirmative action programs.

6. NATIONAL LABOR RELATIONS BOARD

6.1 General Provisions

The purpose of the National Labor Relations Act (NLRA) is to ensure that labor strife does not impede interstate commerce in a major way and to encourage the collective bargaining process as a means to accomplish this purpose. It attempts to protect against abuses of the collective bargaining process on the part of employers, employees, and unions by prohibiting certain unfair labor practices.

This act gives employees the right to form, join, or assist labor organizations and to bargain collectively through representatives of their own choosing as well as engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection. This act also gives employees the right to refrain from these activities unless an agreement requiring membership in a labor organization exists. The act is administered by the National Labor Relations Board through regional offices.

6.2 Prohibited Practices

6.2.1 Employers

The following acts are considered unfair labor practices on the part of employers:

- To interfere with employees in the exercise of their rights to organize.
- To dominate or interfere with the formation or administration of any labor organization, including financial or other support.
- To discriminate against any employee with respect to hiring, discharge, or conditions of employment in order to discourage or encourage union membership or because the employee has filed charges or given testimony under this act.
- To refuse to bargain collectively with the representatives of their employees.

6.2.2 Labor organizations

Labor organizations and their agents (including employees) may not

— Restrain or coerce

Employees with respect to their rights under this act.
Employers in their selection of their representatives for collective bargaining or grievance adjustment purposes.

— Cause or attempt to cause an employer to discriminate against an employee when such discrimination would be an unfair labor practice.

— Refuse to bargain collectively with an employer.

— Engage in or induce or coerce others to engage in unlawful strikes.

— Require excessive membership fees from employees.

— Require payment from an employer for services that have not been or will not be rendered.

— Picket unlawfully.

— Enter into an agreement with an employer in which the employer agrees to cease doing business with any other employer. (There is an exception for the construction industry.)

6.3 Penalties

The National Labor Relations Board (NLRB) has the power to prevent unfair labor practices. If the NLRB finds that any person has engaged or is engaging in any unfair labor practices, it has the power to issue a cease-and-desist order and to take any affirmative action, including reinstatement of employees with or without back pay, consistent with the policies of the NLRA. If the order is not complied with, the NLRB has the right to seek enforcement in any of the Courts of Appeals of the United States.

Employers. Employers may be forced to cease or desist from engaging an unfair labor practices, reinstate employees with or without back pay, and perform other acts consistent with the policies of the NLRA.

Labor organizations, agents. Labor organizations may be ordered to cease and desist from engaging in unfair labor practices along with any other acts, consistent with the purposes of the NLRA.

Employees. Employees who participate in unlawful strikes may be terminated from employment.

Others. Any person who willfully interferes with the NLRB or any member or agent is subject to a fine of not more than $5,000 or imprisonment up to one year.

7. PAYROLL REQUIREMENTS

Employers are required to withhold payroll taxes (FICA and federal and state income tax) from covered employees' wages and remit the withholding to the proper federal and state offices. Employers also must pay payroll taxes for their share of social security (FICA tax) and federal and state unemployment taxes. For a complete listing of types of employment and requirements for withholding employment taxes, see IRS Circular E: *Employer's Tax Guide,* 1988, which is available at any IRS office or by mail from the Internal Revenue Service.

7.1 Federal Insurance Contribution Act (FICA)

The FICA tax rate for 1989 is 7.51 percent for both employees and employers. The wage base is $48,000.

Because of the part-time, irregular nature of farm work, farmers hiring seasonal help are subject to special rules governing how farm workers' wages are reported for social security purposes. Any time the wages of a farm worker exceed $150 in cash during a calendar year, Social Security tax must be paid on the wages. Similarly, wages may count if they are paid on a time basis, such as by the hour, day, week, or month, for any part of twenty or more days during a calendar year. Also, if the total payroll of the agricultural employer is $2,500 or more for the year, any cash wages paid are subject to Social Security tax.

7.2 Federal and State Income Tax

Tables for withholding income tax from employees' wages can be found in IRS Circular E: *Employer's Tax Guide* and state withholding booklets.

7.3 Unemployment Tax

A separate chapter in this manual is devoted to Unemployment Insurance. The Federal Unemployment Tax Act and state unemployment insurance requirements are discussed in sections 3 through 6 of that chapter.

7.4 Deposit of Payroll Taxes

7.4.1 FICA and federal income tax

Employers must make deposits of the FICA and federal income tax withheld from employees' wages plus the employer's share of FICA when the liability reaches certain limits. The following calculation should be used to determine the federal payroll liability.

Gross Wages
× .1502 (Combined employee and employer FICA rate)

XXX FICA
+ XXX FWHT (Federal income tax withheld)
XXX Liability

7.4.2 Rules for depositing federal liability

The following rules apply to periodic deposit of employer and employee shares of payroll tax.

Rule 1. Less than $500 at end of quarter. If at the end of the calendar quarter the total undeposited taxes for the quarter are less than $500, no deposit of the taxes is required. They may be paid to the IRS with Form 941 or deposited with a federal tax deposit coupon (Form 8109).

Rule 2. Less than $500 at the end of any month. If at the end of any month the total undeposited taxes are less than $500, no deposit is necessary. Amount may be carried over to the following month within the quarter.

Rule 3. $500 or more but less than $3,000 at the end of any month. If at the end of any month the total undeposited taxes are $500 or more but less than $3,000, they must be deposited within fifteen days after the end of the month.

Rule 4. $3,000 or more at the end of any eighth monthly period. Each month is divided into eight deposit periods that end on the third, seventh, eleventh, fifteenth, nineteenth, twenty-second, twenty-fifth, and last day of the month. If at the end of any eighth monthly period the total undeposited taxes are $3,000 or more, the funds should be deposited within three banking days after the end of the eighth monthly period. Local holidays observed by authorized financial institutions, Saturdays, Sundays, and legal holidays should not be counted as banking days. Rule 4 will be considered to be met if

— At least 95 percent of tax liability for the eighth monthly period is deposited within three banking days after the end of the period.

— Any underpayment is deposited as follows:

If the eighth monthly period is in the first or second month of the quarter, the underpayment is deposited with the first deposit required to be made after the fifteenth of the following month.

If the eighth monthly period is in the last month of the quarter, any underpayment of $500 or more is deposited by the due date of the return.

Exception. If this is the first time a deposit is required within three banking days after the end of an eighth monthly period, the deposit may be made by the fifteenth of the next month (instead of within three banking days after the eighth monthly period) if *all* of the following conditions are met:

— A deposit was not required under rule 4 during the four quarters preceding the current quarter.

— A deposit was not required under rule 4 during earlier months of this quarter.

— The total undeposited taxes at the end of any eighth monthly period during this month are less than $10,000.

7.4.3 State income tax

All state income tax withheld from employees' wages must be deposited with the proper state agency. Deposit rules vary by state.

7.5 Magnetic Media Reporting

Beginning in 1987 for the tax year 1986, employers who file at least 500 wage or pension information items on Forms W-2 or W-2P will be required to use magnetic media. Beginning in 1988 for the tax year 1987, the number of items used to determine who must file on magnetic media will be reduced to 250. For purposes of IRS regulations, "magnetic media" refers to magnetic tape and diskette. However, regulations indicate that the use of diskette may be limited for Forms W-2 and W-2P.

The IRS regulation provides for a waiver for employers who can show that they will be subject to hardship if required to file a return on magnetic media. A request for waiver generally must be submitted at least ninety days before the filing of the first return for which the waiver is sought. For Forms W-2 and W-2P filed in 1987 and 1988, however, the request for waiver must be submitted by June 30 of the preceding year.

Employers required to file on magnetic media, but who fail to do so, are deemed under the regulation to have failed to file the necessary returns, and will be subject to applicable penalties.

8. POSTEMPLOYMENT ISSUES

8.1 Covenants Not to Compete

A covenant not to compete is a clause in an employment agreement under which an employee agrees not to compete with his or her employer while employed and after terminating employment. To be enforceable, these covenants must be reasonably necessary to protect the employer and they cannot be so restrictive as to prevent the former employee from self-support. Generally, they cannot exceed a geographic area larger than that covered by the employment agreement and are rarely valid if they exceed one year. Unreasonable covenants are not enforceable. Some states allow their courts to edit these covenants to make them reasonable; others simply refuse to enforce them.

8.2 Wrongful Discharge

Wrongful discharge is an action based on the claim that an employee was unlawfully discharged from employment. This claim can be based on some form of discrimination, retaliation for the attempt to exercise a right, or violation of an employment agreement. The employee may be seeking reinstatement, back wages, and/or punitive damages.

8.2.1 Constructive discharge

Constructive discharge is similar to wrongful discharge. The difference is that, under constructive discharge, the employee was not discharged but rather the employer made working conditions so unreasonable that the employee was forced to quit.

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Overtime Compensation Under the Fair Labor Standards Act. Washington, D.C.: U.S. Department of Labor, Wage and Hour Division, 1986.

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Trussell, Ruth C., ed. *U.S. Labor and Employment Laws.* Washington, D.C.: Bureau of National Affairs, 1987.

APPENDIX 1: State Labor Agencies

ALABAMA
All Labor Laws
Department of Industrial Relations
Industrial Relations Building,
Suite 204
Montgomery, Alabama 36130

ALASKA
All Labor Laws
Department of Labor
Commissioner's Office
P.O. Box 21149
Juneau, Alaska 99802-1149
(907)465-2700

ARIZONA
All Labor Laws
P.O. Box 19070
Phoenix, Arizona 85005
(602)255-4515

ARKANSAS
Department of Labor
1022 High St.
Little Rock, Arkansas 72202
(501)682-4500

CALIFORNIA
Department of Industrial Relations
525 Golden Gate Avenue
Room 700D
San Francisco, California 94102
(415)557-3356

COLORADO
Department of Labor and Employment
600 Grant St., Suite 900
Denver, Colorado 80203
(303)837-3800

Industrial Claim Appeals Office
1525 Sherman St.
Denver, Colorado 80203

Division of Labor
1313 Sherman Street
Denver, Colorado 80203

Labor Standards/Relations
1313 Sherman Street
Denver, Colorado 80203

CONNECTICUT
State Board of Labor Relations
200 Folly Brook Blvd.
Wethersfield, Connecticut 06109

Mediation and Arbitration
State Board of Mediation and Arbitration
200 Folly Brook Blvd.
Wethersfield, Connecticut 06109
(203)566-4394

All Other Labor Laws
Labor Department
200 Folly Brook Blvd.
Wethersfield, Connecticut 06109

DELAWARE
All Labor Laws
Office of the Secretary
Delaware Department of Labor
Elbert N. Carvel Bldg., 6th Floor
820 North French St.
P.O. Box 8911
Wilmington, Delaware 19801
(302)571-2710

DISTRICT OF COLUMBIA
Department of Employment Services
500 C Street, N.W., Suite 600
Washington, D.C. 20001

FLORIDA
Division of Labor, Employment and Training
Department of Labor and Employment Security
1320 Executive Center Dr.
300 Atkins Building
Tallahassee, Florida 32399-0667

GEORGIA
All Labor Laws
Department of Labor
Sussex Place
148 International Blvd, N.E.
Atlanta, Georgia 30333

HAWAII
All Labor Laws
Department of Labor and Industrial Relations
830 Punchbowl Street
Honolulu, Hawaii 96813
(808)548-4533

IDAHO
Safety & Labor Regulations
Department of Labor and Industrial Services
277 N. 6th
Statehouse
Boise, Idaho 83720
(208)334-2327

ILLINOIS
Illinois Department of Labor
310 S. Michigan Ave., 10th Floor
Chicago, Illinois 60604

Illinois Department of Labor
1 W. Old State Capitol Plaza
Springfield, Illinois 62701

Fair Labor Standards
310 S. Michigan Ave., 10th Floor
Chicago, Illinois 60604

Wage Claims Section
310 S. Michigan Ave.,
Chicago, Illinois 60604

Department of Employment Security
401 S. State St., 4th Floor
Chicago, Illinois 60605

INDIANA
All Labor Laws
Department of Labor
Indiana State Office Building
Room 1013
100 N. Senate Avenue
Indianapolis, Indiana 46204
(317)232-2663

Mediation and Conciliation
Building and Factory Inspection
IOSHA Administrator
(317)232-2693

Bureau of Child Labor
(317)232-2693

Minimum Wage and Wage Claims
(317)232-2693

IOWA
Labor Laws of Iowa
Division of Labor Services
1000 E. Grand Avenue
Des Moines, Iowa 50319
(515)281-3606

KANSAS
All Labor Laws
Division of Labor-Management Relations and Employment Standards
Kansas Department of Human Resources
512 West 6th Street
Topeka, Kansas 66603
(913)296-7475

KENTUCKY
Labor Cabinet
U.S. 127 South Building
Frankfort, Kentucky 40601
(502)564-3070

LOUISIANA
All Labor Laws
P.O. Box 94094
Baton Rouge, Louisiana 70804
(504)342-3011

MAINE
Labor Relations Board
State Office Building, Station 90
Augusta, Maine 04333
(207)289-2015

All Other Labor Laws
Bureau of Labor Standards
Department of Labor
State Office Building, Station 45
Augusta, Maine 04333

MARYLAND
All Labor Laws
Division of Labor and Industry
501 St. Paul Place
Baltimore, Maryland 21202-2272
(301)333-4179

MASSACHUSETTS
Labor Relations Act
Labor Relations Commission
100 Cambridge Street, Room 1604
Boston, Massachusetts 02202
(617)727-3505

All Other Labor Laws
Department of Labor and Industries
State Office Building
100 Cambridge Street
Boston, Massachusetts 02202
(617)727-3455

MICHIGAN
All Labor Laws
Michigan Department of Labor
309 N. Washington
P.O. Box 30015
Lansing, Michigan 55103
(517)373-9600

MINNESOTA
Bureau of Mediation Services
205 Aurora Avenue
St. Paul, Minnesota 55103
(612)296-2525

Department of Labor and Industry
444 Lafayette Road
St. Paul, Minnesota 55101
(612)296-6107

MISSISSIPPI
All Labor Laws
Occupational Safety and Health Branch
Mississippi State Department of Health
305 West Lovenz Blvd.
P.O. Box 1700
Jackson, Mississippi 39215-1700
(601)987-3981

MISSOURI
Department of Labor and Industrial Relations
P.O. Box 59
421 E. Dunklin Street
Jefferson City, Missouri 65104
(314)751-4091

Division of Employment Security
P.O. Box 59
421 E. Dunklin St.
Jefferson City, Missouri 65104
(314)751-3215

All Other Labor Laws
Division of Labor Standards
P.O. Box 449
Jefferson City, Missouri 65102

MONTANA
All Labor Laws
Department of Labor and Industry
Capitol Station
P.O. Box 1728
Helena, Montana 59620
(406)444-3555

NEBRASKA
Department of Labor
Box 94600
State House Station
Lincoln, Nebraska 68509
(402)475-8451

NEVADA
All Labor Laws
Nevada State Labor Commission
505 E. King St., Room 602
Carson City, Nevada 89710
(702)885-4850

NEW HAMPSHIRE
Department of Labor
19 Pillsbury Street
Concord, New Hampshire 03301
(603)271-3176

NEW JERSEY
Department of Labor
John Fitch Plaza
CN-110
Trenton, New Jersey 08625
(609)292-2323

NEW MEXICO
State Labor and Industrial Commission
230 W. Manhattan
Santa Fe, New Mexico 87501
(505)827-3915

Wage and Hour Bureau
509 Mountain Rd. N.E.
Albuquerque, New Mexico 87102

NEW YORK
State Labor Relations Act
New York State Labor Relations Board
2nd Floor
400 Broome Street
New York, New York 10013

NORTH CAROLINA
Wage and Hour Division
4 West Edenton St.
Raleigh, North Carolina 27601

All Other Labor Laws
4 West Edenton Street
Raleigh, North Carolina 27601
(919)733-7166

NORTH DAKOTA
All Labor Laws
State Capitol, 5th Floor
Bismarck, North Dakota 58505
(701)224-2660

OHIO
Department of Industrial Relations
Division of Prevailing Wage, Minimum Wage & Minors
2323 W. 5th Ave.
Columbus, Ohio 43204
(614)481-5415

OKLAHOMA
All Labor Laws
Department of Labor
Employment Standards Division
1315 N. Broadway Place
Oklahoma City, Oklahoma 73103
(405)235-0530

OREGON
Employment Relations Board
528 Cottage Street, N.E.
Suite 400
Salem, Oregon 97310
(503)378-3807

All Other Labor Laws
Bureau of Labor and Industries
4th Floor, State Office Building
1400 S.W. Fifth Avenue
Portland, Oregon 97201
(503)229-5737

PENNSYLVANIA
State Public & Private Sector Labor Relations Act
Pennsylvania Labor Relations Board
1617 Labor and Industry Building
Seventh and Forster Streets
Harrisburg, Pennsylvania 17120

All Other Labor Laws
Department of Labor and Industry
1700 Labor and Industry Building
Seventh and Forster Streets
Harrisburg, Pennsylvania 17120

PUERTO RICO
Commonwealth Labor Relations Act
Puerto Rico Labor Relations Board
San Juan, Puerto Rico

All Other Labor Laws
Department of Labor and Human Resources
505 Munoz Rivera Ave.
Hato Rey, Puerto Rico 00918
(809)754-2119

RHODE ISLAND
State Labor Relations Act
Rhode Island Labor Relations Board
220 Elmwood Ave.
Providence, Rhode Island 02907

All Other Labor Laws
Department of Labor
220 Elmwood Ave.
Providence, Rhode Island 02907

SOUTH CAROLINA
All Labor Laws
Department of Labor
3600 Forest Drive
P.O. Box 11329
Columbia, South Carolina 29211

SOUTH DAKOTA
Department of Labor
Division of Labor and Management
700 Governor's Drive
Pierre, South Dakota 57501
(605)773-3681

TENNESSEE
All Labor Laws
Department of Labor
501 Union Bldg., Second Floor
Nashville, Tennessee 37219-5385
(615)741-2582

TEXAS
All Labor Laws
Department of Labor and Standards
P.O. Box 12157, Capitol Station
Austin, Texas 78711
(512)463-2906

UTAH
State Labor Relations Act
Industrial Commission of Utah
160 East 300 South, 3rd Floor
P.O. Box 5800
Salt Lake City, Utah 84110
(801)530-6811

Labor & Anti-Discrimination Division
160 East 300 South, 3rd Floor
P.O. Box 5800
Salt Lake City, Utah 84110
(801)530-6811

VERMONT
All Labor Laws
Department of Labor and Industry
120 State Street
Montpelier, Vermont 05602
(802)828-2286

VIRGINIA
All Labor Laws
Department of Labor and
Industry
205 North 4th Street
P.O. Box 12064
Richmond, Virginia 23241
(804)786-2376

WASHINGTON
All Labor Laws
Department of Labor and
Industries
General Administration Building
(HC 101)
Olympia, Washington 98504
(206)753-6307

WEST VIRGINIA
All Labor Laws
Department of Labor
Room 319
1800 Washington St., East
Charleston, West Virginia 25305
(304)348-7890

WISCONSIN
Department of Industry, Labor
and Human Relations
P.O. Box 7946
Madison, Wisconsin 53707

WYOMING
All Labor Laws
Department of Labor and
Statistics
Herschler Building
122 W. 25th
Cheyenne, Wyoming 82002

APPENDIX 2: State Civil Rights Agencies

These agencies have overall responsibility for preventing and redressing discrimination due to race, color, sex, age, national origin, religion, or handicap in employment, education, housing, public accommodations, and credit.

ALASKA
Human Rights Comm.
Off. of the Governor
800 A Street
Suite 202
Anchorage, AK 99501
(907)276-7474

ARIZONA
Civil Rights Div.
Off. of Attorney Gen.
1275 W. Washington
Phoenix, AZ 85007
(602)255-5263

CALIFORNIA
Dept. of Fair Employment
& Housing
1201 I St., Suite 211
Sacramento, CA 95814
(916)323-5256

COLORADO
Civil Rights Div.
Dept. of Regulatory Agencies
1515 Sherman St.
Rm. 600C
Denver, CO 80203
(303)866-2624

CONNECTICUT
Comm. on Human Rights
& Opportunities
90 Washington St.
Hartford, CT 06106
(203)566-3350

FLORIDA
Off. of Civil Rights
2590 Executive Center Drive
209 Berkeley Bldg.
Tallahassee, FL 32399-2152
(904)488-5905

IDAHO
Human Rights Comm.
450 W. State St.
Boise, ID 83720
(208)334-2873

ILLINOIS
Dept. of Human Rights
100 W. Randolph
Suite 10-100
Chicago, IL 60601
(312)917-6200

INDIANA
Civil Rights Comm.
311 W. Washington St.
Rm. 319
Indianapolis, IN 46204-2773
(317)232-2612

IOWA
Civil Rights Comm.
211 E. Maple-2nd Floor
c/o Grimes State Office Bldg.
Des Moines, IA 50319
(515)281-4121

KANSAS
Comm. on Civil Rights
Landon State Office Bldg.
900 S.W. Jackson, 8th Floor,
Suite 851 S.
Topeka, KS 66612
(913)296-3206

KENTUCKY
Comm. on Human Rights
Capital Plaza Tower
Frankfort, KY 40601
(502)564-3550

LOUISIANA
Dept. of Justice
P.O. Box 94005
Baton Rouge, LA 70804-9005
(504)342-7013

MAINE
Human Rights Comm.
State House Station 51
Augusta, ME 04333
(207)289-2326

MARYLAND
Human Relations Comm.
20 E. Franklin St.
Baltimore, MD 21202
(301)333-1700

MASSACHUSETTS
Comm. Against Discrimination
One Ashburton Pl.
Rm. 601
Boston, MA 02108
(617)727-7319

MICHIGAN
Dept. of Civil Rights
303 W. Kalamazoo
P.O. Box 30221
Lansing, MI 48913
(517)334-6079

MINNESOTA
Dept. of Human Rights
500 Bremer Tower
Seventh & Minnesota Sts.
St. Paul, MN 55101
(612)296-5663

MISSOURI
Comm. on Human Rights
Labor & Industrial Relations Dept.
315 Ellis Blvd.
P.O. Box 1129
Jefferson City, MO 65102
(314)751-3325

MONTANA
Human Rights Div.
Dept. of Labor & Industry
Capital Station
Helena, MT 59620
(406)444-2884

NEBRASKA
Equal Opportunity Comm.
301 Centennial Mall
P.O. Box 94934
Lincoln, NE 68509-4934
(402)471-2024

NEVADA
Equal Rights Comm.
1515 E. Tropicana, 590
Las Vegas, NV 89158
(702)486-7161

NEW HAMPSHIRE
Comm. For Human Rights
61 S. Spring St.
Concord, NH 03301
(603)271-2767

NEW JERSEY
Div. on Civil Rights
Dept. of Law & Public Safety
1100 Raymond Blvd.
Newark, NJ 07102
(201)648-2700

NEW MEXICO
Department of Labor
Human Rights Division
930 Baca St.
Santa Fe, NM 87501
(505)827-6420

NEW YORK
Div. of Human Rights
Executive Dept.
2 World Trade Ctr.
New York, NY 10047
(212)488-5750

NORTH CAROLINA
Human Relations Council
Dept. of Administration
121 W. Jones St.
Raleigh, NC 27603
(919)733-7996

NORTH DAKOTA
Dept. of Labor
5th Fl., State Capitol
Bismarck, ND 58505
(707)224-2661

OHIO
Civil Rights Comm.
220 Parsons Ave.
Columbus, OH 43215
(614)466-6715

OKLAHOMA
Human Rights Comm.
Jim Thorpe Bldg., Room 480
Oklahoma City, OK 73105
(405)521-3441

OREGON
Civil Rights Div.
Bur. of Labor & Industries
1400 SW Fifth Ave.
Portland, OR 97201
(503)229-5900

PENNSYLVANIA
Human Relations Comm.
101 S. Second St.
Suite 300
Harrisburg, PA 17101
(717)787-4410

RHODE ISLAND
Human Rights Comm.
10 Abbott Park Pl.
Providence, RI 02903
(401)277-2661

SOUTH CAROLINA
Comm. on Human Affairs
P.O. Box 11009
Columbia, SC 29211
(803)737-6570

SOUTH DAKOTA
Div. of Human Rights
Commerce & Regulations Dept.
State Capitol
Pierre, SD 57501
(605)773-3177

TENNESSEE
Comm. for Human Rights
Capitol Blvd. Bldg., Suite 602
226 Capitol Blvd.
Nashville, TN 37219
(615)741-5825

TEXAS
Texas Comm. on Human Right
P.O. Box 13493
Austin, TX 78711
(512)459-0944

UTAH
Labor and Anti-Discrimination
Division
Industrial Comm.
160 E. 300 St.
P.O. Box 45580
Salt Lake City, UT 84110-580(
(801)530-6801

VERMONT
Public Protection Div.
Off. of Attorney Gen.
109 State St.
Montpelier, VT 05602
(802)828-3171

WASHINGTON
Human Rights Comm.
402 Evergreen Plaza Bldg.
Olympia, WA 98504
(206)753-6770

WEST VIRGINIA
Human Rights Comm.
1036 Quarrier St.
Charleston, WV 25301
(304)348-2616

WISCONSIN
Div. of Equal Rights
Industry, Labor & Human Relations
P.O. Box 7946
Madison, WI 53707
(608)266-0946

WYOMING
Dept. of Administration & Fiscal Control
Emerson Bldg.
Cheyenne, WY 82002
(307)777-6730

DISTRICT OF COLUMBIA
Off. of Human Rights
2000 14th St., N.W., 3rd Floor
Washington, DC 20009
(202)939-8740

GUAM
Dept. of Law
Office of Attorney General
238 Archbishop F.C. Flores St.
Suite 701, Pacific News Bldg.
Agana, GU 96910
(671)472-6841

PUERTO RICO
Civil Rights Comm.
P.O. Box 2338
Hato Rey, PR 00919
(809)764-8686

VIRGIN ISLANDS
Civil Rights Comm.
P.O. Box 6645
St. Thomas, VI 00801
(809)776-2485

APPENDIX 3: State Equal Employment Opportunity Agencies

These agencies enforce laws promoting equal employment opportunity.

ALABAMA
Equal Opportunity Employment Off.
Dept. of Industrial Relations
649 Monroe St.
Montgomery, AL 36130
(205)261-5355

ALASKA
Equal Employment Opportunity Div.
Office of the Governor
P.O. Box AE
Juneau, AK 99811
(970)465-3570

ARIZONA
Affirmative Action Off.
State Capital Bldg.
Suite 260, West Wing
Phoenix, AZ 85007
(602)255-3711

ARKANSAS
Finance & Admin. Dept.
401 DFA Bldg.
1509 W. 7th St.
Little Rock, AR 72201
(501)371-2242

CALIFORNIA
Dept. of Fair Employment and Housing
1201 I St., Suite 211
Sacramento, CA 95814
(916)323-5256

COLORADO
Civil Rights Div.
Dept. of Regulatory Agencies
1525 Sherman St.
Rm. 600C
Denver, CO 80203
(303)866-2621

CONNECTICUT
Comm. on Human Rights & Opportunities
90 Washington St.
Hartford, CT 06106
(203)566-3350

DELAWARE
Dept. of Labor
820 N. French St.
Wilmington, DE 19801
(302)571-2710

FLORIDA
Human Relations Comm.
325 John Knox Rd.
Suite 240, Building F
Tallahassee, FL 32399-1570
(904)488-7082

GEORGIA
Ga. Off. of Fair Employment Practice
156 Trinity Ave., S.W.
Suite 208
Atlanta, GA 30303
(404)656-1736

HAWAII
Off. of Affirmative Action
Off. of the Governor
Rm. 443, State Capitol
Honolulu, HI 96813
(808)548-3432

IDAHO
Human Rights Comm.
450 W. State St.
Boise, ID 83720
(208)334-2873

ILLINOIS
Dept. of Human Rights
100 W. Randolph
Suite 10-100
Chicago, IL 60601
(312)917-6245

INDIANA
Civil Rights Comm.
311 W. Washington St.
Rm. 319
Indianapolis, IN 46204-2773
(317)232-2612

IOWA
Civil Rights Comm.
Liberty Bldg.
Des Moines, IA 50319
(515)281-4478

KANSAS
Equal Opportunity Off.
Dept. of Admin.
900 Jackson
Rm. 852
Landon State Office Bldg.
Topeka, KS 66612-1220
(913)296-4288

KENTUCKY
Comm. on Human Rights
Capital Plaza Tower
Frankfort, KY 40601
(502)564-3550

LOUISIANA
Off. of Labor
Dept. of Labor
P.O. Box 94094
Baton Rouge, LA 70804-9094
(504)925-4221

MAINE
Human Rights Comm.
State House Station 51
Augusta, ME 04333
(207)289-2326

MARYLAND
Comm. on Human Relations
20 E. Franklin St.
Baltimore, MD 21202
(301)333-1700

MASSACHUSETTS
Off. of Affirmative Action
One Ashburton Pl.
Rm. 301
Boston, MA 02108
(617)727-7441

MICHIGAN
Dept. of Civil Rights
303 W. Kalamazoo
Lansing, MI 48913
(517)334-6079

MINNESOTA
Office of Job Service & UI Operations
Dept. of Jobs & Training
390 N. Robert St.
St. Paul, MN 55101
(612)296-3625

MISSISSIPPI
Equal Employment Opportunity Dept.
Employment Security Comm.
P.O. Box 1699
Jackson, MS 39215-1699
(601)961-7421

MISSOURI
Comm. on Human Rights
Labor & Industrial Relations Dept.
315 Ellis Blvd., Box 1129
Jefferson City, MO 65102
(314)751-3325

MONTANA
Human Rights Div.
Dept. of Labor & Industry
P.O. Box 1728
Helena, MT 59624-1728
(406)444-2884

NEBRASKA
Equal Opportunity Comm.
301 Centennial Mall Street
P.O. Box 94934
Lincoln, NE 68509-4934
(402)471-2024

NEVADA
Equal Rights Comm.
1515 E. Tropicana, 590
Las Vegas, NV 89158
(702)486-7161

NEW HAMPSHIRE
Comm. for Human Rights
16 S. Spring St.
Concord, NH 03301
(603)271-2767

NEW JERSEY
Div. of Equal Employment Opportunity & Affirmative Action
Dept. of Personnel
Front & Montgomery Sts., CN315
Trenton, NJ 08625
(609)984-4333

NEW MEXICO
Human Rights Comm.
930 Baca St.
Santa Fe, NM 87501
(505)827-6420

NEW YORK
Dept. of Civil Service
W. Averell Harriman State Office
Building Campus
Building #1
Albany, NY 12239
(518)457-2487

NORTH CAROLINA
Equal Opportunity Services Div.
Off. of State Personnel
116 W. Jones St.
Raleigh, NC 27603-8004
(919)733-0205

NORTH DAKOTA
Dept. of Labor
5th Fl., State Capitol
Bismarck, ND 56505
(701)224-2661

OHIO
Civil Rights Comm.
220 Parsons Ave.
Columbus, OH 43215
(614)466-6715

OKLAHOMA
Affirmative Action Off.
Employment Security Comm.
212 Will Rogers Bldg.
Oklahoma City, OK 73105
(405)521-3769

OREGON
Employment Div.
Dept. of Human Resources
875 Union St., NE
Salem, OR 97301
(503)378-3211

PENNSYLVANIA
Human Relations Comm.
101 S. Second St.
Suite 300
Harrisburg, PA 17105
(717)787-4410

RHODE ISLAND
Dept. of Admin., Div. of Human Services
Equal Opportunity Off.
289 Promenade St.
Providence, RI 02903
(401)227-3090

SOUTH CAROLINA
Employment Security Comm.
1550 Gadsden St.
P.O. Box 995
Columbia, SC 29202
(803)737-3090

SOUTH DAKOTA
Bur. of Personnel
118 W. Capital
Pierre, SD 57501
(605)773-3148

TENNESSEE
Equal Employment Opportunity
Dept. of Employment Security
527 Cordell Hull Bldg.
Nashville, TN 37219
(615)741-0921

TEXAS
Governor's Equal Employment Comm.
P.O. Box 12428
Capitol Station
Austin, TX 78711
(512)475-6507

UTAH
Labor/Anti-Discrimination Div.
160 E. 300 St.
Salt Lake City, UT 84110-5800
(801)530-6801

VERMONT
Office of the Attorney General Civil Rights
Pavilion Office Bldg.
109 State St.
Montpelier, VT 05602
(802)828-3171

VIRGINIA
Office of Equal Employment Services
Dept. of Personnel & Training
101 N. 14th St.
Richmond, VA 23219
(804)225-2237

WASHINGTON
Affirmative Action Program
Dept. of Personnel
600 S. Franklin
Box 1789
Olympia, WA 98504
(206)753-3758

WEST VIRGINIA
Civil Service System
Civil Service Comm.
1900 Washington, St. E.
Charleston, WV 25305
(304)348-3950

WISCONSIN
Div. of Equal Rights
Industry, Labor & Human Relations
P.O. Box 8928
Madison, WI 53708
(608)266-6860

WYOMING
Dept. of Labor & Statistics
Herschler Bldg.
Cheyenne, WY 82002
(307)777-7261

DISTRICT OF COLUMBIA
Off. of Human Rights
420 Seventh St., NW
Rm. 200
Washington, DC 20004
(202)727-3100

AMERICAN SAMOA
Dept. of Human Resources
Pago Pago, AS 96799
(684)633-4489

GUAM
Dept. of Labor
P.O. Box 23548
GMF, GU 96921
(671)646-9241

NORTHERN MARIANA
ISLANDS
Dept. of Commerce & Labor
Commonwealth of the Northern
Mariana Islands
Capitol Hill
Saipan, CM 96950
(011)670-7261

PUERTO RICO
Fair Employment
Labor & Human Resources Dept.
505 Munoz Rivera Ave.
Hato Rey, PR 00918
(809)754-2105

VIRGIN ISLANDS
Div. of Labor Relations
Dept. of Labor
P.O. Box 148
St. Thomas, VI 00801

WORKERS' COMPENSATION

WORKERS' COMPENSATION

1. INTRODUCTION

1.1 Background

Before workers' compensation benefits became statutory, injured employees who sought compensation for a loss were obliged to sue their employers under the civil negligence laws. Such action was very lengthy and costly, and many times the employee did not receive any compensation at all. As the inequity of this system became widely realized, states developed plans whereby employees gave up their right to sue the employer for negligence. In return, the employer was required to guarantee certain benefits. A system of insurance was designed to implement this plan, and workers' compensation was formed. In the course of time, workers' compensation has shifted the burden of industrial injury to the cost of production and established a system compensating employees for injuries, established by state law.

1.2 Purpose

The purpose of workers' compensation laws is to provide a uniform and fair system of compensating employees for work-related injuries, diseases, and deaths.

Workers' compensation laws make the employer strictly liable to an employee for injuries sustained by the employee that arise out of and in the course of employment. This liability is paid for by workers' compensation insurance policies, self-insured employer plans, or state funds. In awarding compensation for injuries, negligence on the part of the employer or employee has been disregarded, with compensation uniformly held to be a no-fault exclusive remedy. All states have workers' compensation laws that provide medical, compensation, and other benefits for injuries. Although these laws vary from state to state, they are broadly similar in their provisions.

2. DEFINITIONS

Employer. An entity engaged in a business effecting commerce that has employees (29 U.S.C. Section 652(5)).

Employee. One employed in a business of an employer that effects commerce (29 U.S.C. Section 652(6)).

Commerce. "Trade, traffic, commerce, transportation, or communication among the several states, or between a state and any place outside thereof, or within the District of Columbia, or a possession of the United States . . . , or between points in the same state but through a point outside thereof" (29 U.S.C. Section 652(3)).

3. FEDERAL REGULATIONS

3.1 Coverage

A determination of the exact jurisdiction and benefits applicable to a particular workers' compensation claim depends on the jurisdiction and benefit provisions of each state's workers' compensation statute. Each state has its own law establishing benefits and jurisdictional considerations. In addition to state laws, there are several federal workers' compensation statutes that provide workers' compensation coverage for certain specified groups of employees. These federal statutes include the District of Columbia Workers' Compensation Act (for injuries occurring before July 30, 1982), the Federal Employees Workers' Compensation Act, and the Longshore and Harbor Workers' Compensation Act.

Exemptions from workers' compensation coverage are discussed in section 3.3 of this chapter.

3.2 Compulsory Coverage

Workers' compensation laws are classified as either compulsory or elective. Under a compulsory law, every employer must accept the act and must provide the specified compensation benefits. Under an elective act, employers have the option of either accepting or rejecting the benefits under the act. However, if the act is rejected, the employer loses the customary common law defenses, such as assumption of the risk by an employee, negligence of fellow employees, and contributory negligence of an employee.

Today, most states have compulsory workers' compensation laws. Accordingly, some form of insurance is mandatory for covered employers. Specific requirements for coverage, as well as penalties for failure to insure, vary considerably from state to state and can be learned only by examining the appropriate state regulations. New employers should contact their state workers' compensation authority to determine the exact requirements for workers' compensation insurance.

3.3 Employees

Compensation for work-related injuries will only be paid to employees, a definition that generally includes both part-time and temporary employees. Professional and managerial employees are also considered employees. Certain types of employees may nevertheless be excluded from coverage under workers' compensation laws (for example, partners, some corporate officers, family members, volunteers, farm and domestic labor, and students). State regulations must be examined to determine exemption.

Sole proprietors are not considered "employers" or "employees" and are generally not covered under workers' compensation laws. Again, it is necessary to examine state laws to make a final determination.

The employer is responsible for compensating the injured employee. In general, workers are compensated for their loss of wages while out of work because of an injury, for their permanent disabilities and loss of wage-earning capacity, and for their medical needs. The amount of compensation varies from state to state, and benefits are paid directly by an employer's workers' compensation insurer or from a self-insured fund. Specific categories of benefits are discussed in section 3.13 of this chapter.

3.4 Employers

All employers covered under workers' compensation regulations are classified into specific groups by the nature of their business and activities, classifications based on the degree of risk of injury and accidents involved in the business.

All employers must be aware of their primary legal responsibilities and duties to injured employees. Under workers' compensation laws, the exact definition of *employer* varies from state to state. For example, some states base their definition on the number of employees a particular person employs. Again, individual state statutes must be reviewed. Whenever an employer is required to provide workers' compensation coverage, most laws require that he or she file certain reports and keep certain records.

3.5 Financing and Recordkeeping

Covered employers are liable for the cost of workers' compensation insurance, and the cost may not be passed along to employees.

Accurate wage records must be kept for all covered workers and be available for review, inspection, or audit at all times. Failure to comply may result in penalties and fines.

Management is responsible for understanding and meeting the requirements of the various workers' compensation statutes in states where its employees are situated. Management must establish a system to ensure that covered employees and their salary bases are properly accounted for and reported. Employees should be properly classified and these classifications periodically reviewed in connection with rate changes. The claims-handling process should also be re-evaluated periodically.

3.6 Rates

Accident experience throughout American business is compiled by the National Council on Compensation Insurance. The council is recognized by all insurance carriers and state fund administrators. Rates are determined in accord with a standard nationwide rate-making procedure approved by the National Association of Insurance Commissioners. The National Council on Compensation Insurance has issued an experience-rating-plan manual that is standard with all insurance companies.

Workers' compensation rates are assigned to employers based on the employer's classification. The rate is usually expressed as a percentage of payroll paid by an employer and is adjusted according to the employer's accident record. Employers in the same classification may have different rates based on the number of accidents their workers experience. In this way, the cost of workers' compensation is spread out more justly.

3.7 Wage Base

The rate assigned an employer is applied to the employer's wage base to determine the employer's workers' compensation liability. The wage base is the estimated wages an employer will pay in a year and should be adjusted periodically according to state regulations.

Wage-base audits are made periodically to determine whether an employer has overpaid or underpaid. A wage-base audit compares the estimated wage base to the actual wages paid for a specified period.

3.8 Accidental Injury

Most state and federal workers' compensation laws require that an injury be "accidental" in nature. The majority of states find an injury to be accidental if its cause was of a chance nature or if its effect was the unexpected result of the routine performance of an employee's normal job duties. A few states require proof that an employee's injury was in some way unusual and not merely the result of performing normal job duties.

3.9 Arising Out of Employment

All state and federal workers' compensation laws require that an injury "arise out of" the employment in order to be compensable. An injury generally is said to arise out of the employment when conditions of the employment cause the injury.

3.10 In the Course of Employment

All state and federal workers' compensation laws also require that an injury occur "in the course of" employment. The time, place, and activity of the employee are demonstrative of whether the injury occurred in the course of employment. For example, in most states, many injuries that occur while employees are on their way to and from work are generally held not to occur in the scope of the employment and are thereby not covered under workers' compensation laws.

3.11 Occupational Diseases

In addition to coverage for accidental injuries, most workers' compensation laws provide compensation for employees who sustain occupational diseases that arise out of and in the course of employment. In general, while an accidental injury arises from a specific event, occupational diseases result from repeated exposure over a long period of time to some condition that is characteristic of the employment. The exact definition of an occupational disease and the benefits payable for such a disease vary from state to state. Some states provide workers' compensation coverage not only for physical diseases, but also for mental diseases arising from employment, such as work-related mental and emotional stress and psychiatric disorders.

3.12 Accident Reports

Employees are legally required to report accidents to their employers as soon as possible. In turn, employers are required to submit reports of accidents and injuries to the proper authorities in their state. In many states the report should be made to the state workers' compensation board, but this varies from state to state. Failure to report an accident by an employer may result in penalties and fines. These limitation periods vary from state to state and may require that a claim be filed as soon as one year following an injury, or as long as three years.

3.13 Benefits

An employee can recover the costs of hospitalization, medical care, and other expenses resulting from a work-related injury. In addition, an employee is generally entitled to receive disability benefits as a replacement for temporary wage loss while out of work following an injury or as compensation for a permanent disability.

3.13.1 Categories of benefits

There are four basic categories of workers' compensation benefits:

1. *Temporary Total Benefits.* These benefits are for a disability that is temporary in quality and total in character. They are wage loss benefits and are generally payable to employees out of work following an injury and before maximum medical improvement is reached.
2. *Temporary Partial Benefits.* These benefits are for a disability that is temporary in quality and partial in character. They are wage loss benefits and are payable when an employee returns to work at a lighter-duty and lower-paying job, but before the employee reaches maximum medical improvement.
3. *Permanent Partial Benefits.* These benefits are for a disability that is permanent in quality and partial in character. They are monetary benefits in addition to medical treatment and care for a permanent disability and may be based on a percentage of anatomical disability or on a permanent loss of wage-earning capacity, depending on the provisions of a state's statute. The amount of permanent partial benefits may be based upon the part of the body that is injured, such as the arm, the leg or the back.
4. *Permanent Total Benefits.* These benefits are for a disability that is permanent in quality and total in character. They are payable when an employee is permanently unable to return to work at his or her regular job or to any form of gainful employment.

3.13.2 Vocational rehabilitation

When an employee is physically unable to return to work at his or her regular job following a work-related injury, but is able to work at alternative jobs, most workers' compensation laws require employers to provide vocational rehabilitation services. Vocational rehabilitation may include vocational guidance, counseling, testing, retraining, and relocation. Job placement, education, and assistance in modification of an employee's home to accommodate a disability may also be included in vocational rehabilitation.

The extent of required vocational rehabilitation varies considerably from state to state. Some states provide for a fund from which an employer may seek payment to cover the cost of rehabilitation. Other states do not provide for such a fund, and the cost of rehabilitation is usually directly paid by the employer's workers' compensation insurer.

3.13.3 Death benefits

When an employee dies as the result of a work-related injury, his or her surviving spouse, children, or other dependents may be entitled to death benefits. The amount of such benefits varies depending on whether a dependent was totally dependent on the deceased employee's income for support, or only partially dependent. Death benefits may also include some reimbursement for funeral expenses and some education costs for minor children up through college. The specific requirements and amounts of death benefits vary substantially from state to state.

3.13.4 Benefits for pre-existing disabilities

In some cases, an employee's work-related permanent disability may be superimposed over a pre-existing disability or injury. In such situations, some states have special funds established under the workers' compensation statute that may be responsible for payment of permanent disability benefits to an employee for a pre-existing disability. The policy behind such special funds is to ensure that an employer is responsible for only the disability caused by a work-related injury and to encourage employers to hire employees with pre-existing disabilities or handicaps.

3.14 Tax Consequences

Workers' compensation premiums are deductible as a business expense by employers. The benefits are not taxable to the employee.

4. OCCUPATIONAL SAFETY AND HEALTH

Occupational safety and health standards help create a safe and healthful work environment, which in theory reduces the number of workers' compensation claims filed against employers.

4.1 Background

The Occupational Safety and Health Act (OSHA) was enacted by Congress in 1970 because states were not providing adequate protection for workers. It is an attempt to provide uniform standards and a method of enforcement.

In general, OSHA covers all employers and employees in all fifty states, the District of Columbia, Puerto Rico, and all other federal territories. The act does not cover self-employed persons, farms where only immediate members of the farmer's family work, and workplaces already protected by other federal laws. Although federal agencies are covered, OSHA does not cover employees of state and local governments. However, many states have laws with requirements similar to those of OSHA.

4.2 Scope and Purpose

The purpose of the act is to "assure so far as possible every working man and woman in the Nation safe and healthful working conditions. . . ." The statute looks to a number of methods to carry out this purpose. These methods include voluntary efforts by employees and employers as well as joint labor/management to reduce hazards, standards promulgated by the federal secretary of labor, effective means to enforce the standards, research into causes and prevention of occupational injuries and disease, and encouragement of state efforts.

4.3 Compliance With OSHA

Employers have an obligation to provide places and working conditions free from recognized hazards, and both employers and employees have an obligation to comply with OSHA standards. Employers and employees who do not comply with OSHA standards may be subject to civil fines and/or imprisonment. The nature of the fine and the length of imprisonment depend on the nature of noncompliance (629 U.S.C. 666).

Enacted safety standards are published in the Code of Federal Regulations. Proposed safety standards are published in the Federal Register. Employers may obtain temporary or permanent variances from standards by showing that noncompliance is due to circumstances beyond their control or that existing working conditions are as safe as the proposed OSHA standards. Employees have the right to a hearing on employers' requested variances.

4.4 Relation to State Laws

This act is not meant to affect any workers' compensation act or any existing common law or statutory duties, rights, or liabilities of employers and employees with respect to occupational safety and health (29 U.S.C. 653(a)). States may regulate any occupational safety or health issue with respect to which there are no standards in effect under OSHA. They may also regulate issues already covered by OSHA standards upon submission to and approval of a plan for development of standards and enforcement that are at least as effective as OSHA standards and enforcement (29 U.S.C. 667(a)(b)). See the appendix at the end of this chapter for a complete list of state agencies and addresses.

5. STATE INFORMATION AND OFFICES

A compulsory statute applies to all employers who are not specifically excluded, and excluded employers are often covered voluntarily. An elective statute either applies to all employers who elect to be covered by the statute or does not apply to those employers who reject the statute. Employers who opt out of elective statutes may be sued without being able to use common-law defenses that were available before the statutes were enacted.

The penalty for the failure to insure varies widely from state to state. It can include a fine, imprisonment, or an injunction from doing business or engaging in employment activities. Many states also allow injured workers to sue their employers with the common-law defenses either as an alternate remedy to the compensation provided by the statute or in addition to that compensation. If the employer is a corporation, officers are frequently held personally liable for penalties, damages, and compensation.

The following is a brief state-by-state analysis of workers' compensation laws as they relate to private employment.

Alabama The statute is compulsory. Insurance is required of all employers with three or more employees. Failure to insure is subject to a fine from $25 to $1,000. An injured employee may sue the employer and receive double compensation under the statute.

Code of Alabama. Section 25-5-1 et. seq.

Workmen's Compensation Division
Department of Industrial Relations
649 Monroe St.
Montgomery, AL 36130
(205)261-5420

Alaska The statute is compulsory. Insurance is required of all employers. According to the U.S. Chamber of Commerce, *Analysis of Worker's Compensation Laws*, 1986 (cited hereafter as *Analysis*) the failure to insure is a class B or C felony subject to a fine up to $10,000, imprisonment up to ten years, or both. Section 23.30.075(b) of the

Alaska Statutes provides for a fine up to $1,000 or imprisonment up to one year, or both. The employer may be enjoined from doing business if the employer is sued and negligence is presumed. Corporate officers and managers are personally liable.

Alaska Statutes. Section 23.30.005 et. seq.

Division of Workers' Compensation
Department of Labor
P.O. Box 1149
Juneau, AK 99802
(907)465-2790

Arizona The statute is compulsory. Insurance is required of all employers. An injured employee may elect to receive compensation under the statute or to pursue legal remedies in tort. The employer may be enjoined from doing business if the employer fails to insure. An injured worker will be awarded compensation and a 10 percent penalty plus ex-

(Text continued on page 59)

penses, and attorneys' fees or $500 (whichever is greater) will be imposed on the employer. This award is paid from a special fund and must be reimbursed with 10 percent interest.

Arizona Revised Statutes. Section 23-901 et. seq.

State Compensation Fund
1616 W. Adams St.
Phoenix, AZ 85007
(602)255-5259

Arkansas The statute is compulsory. Coverage is required for all employers with three or more employees. Failure to insure is subject to a fine of $500, imprisonment of one year, or both. An employee may also elect to receive compensation under the statute or to sue the employer.

Arkansas Statutes. Section 81-1301 et. seq.

Workers' Compensation Commission
2nd Floor, Justice Bldg.
Little Rock, AR 72201
(501)372-3930

California The statute is compulsory. Insurance is required of all employers. If an employer is enjoined from doing business there is a penalty of $100 per employee, with $500 for compensable cases (up to $10,000). Intentional failure to insure and failure to obey an injunction are both misdemeanors, subject to a fine up to $1,000, imprisonment up to sixty days, or both. The injured worker may receive compensation and sue the employer.

California Labor Code. Section 3201 et. seq.

Industrial Accidents Division
Department of Industrial Relations
525 Golden Gate Ave., No. 610
San Francisco, CA 94102
(415)557-3542

Colorado The statute is compulsory. Insurance is required of all employers. An employer who fails to insure may be enjoined from doing business. An injured worker may elect to receive compensation plus 50 percent under the statute or to pursue legal remedies.

Colorado Revised Statutes. Section 8-40-101 et. seq.

Division of Labor
Department of Labor & Employment
1313 Sherman St., Room 314
Denver, CO 80203
(303)866-2782

Connecticut This statute is compulsory. Insurance is required of all employers. Willful failure to insure is subject to a fine up to $1,000.

Connecticut General Statutes. Section 31-275 et. seq.

Workers' Compensation Commission
60 Connelly St., Bldg. 12
Hamden, CT 06514
(203)789-7783

Delaware The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine of $.10 per day per employee (not less than $1 nor more than $50). The employer may be enjoined from doing business if failure to insure continues for thirty days. An injured worker may elect to receive compensation or to sue the employer who fails to insure.

Delaware Code. Section 2301 et. seq.

Division of Industrial Affairs
Department of Labor
820 N. French St.
Wilmington, DE 19801
(302)571-2877

Florida The statute is compulsory. Insurance is required of all employers with three or more employees. Failure to insure is subject to a fine up to $500, imprisonment up to one year, or both. An employer may be enjoined from doing business. The injured worker may elect to receive compensation or to sue the employer.

Florida Statutes. Section 44.01 et. seq.

Division of Workers' Compensation
Labor & Employment Security Dept.
201 Ashley Bldg.
Tallahassee, FL 32301
(904)488-2514

Georgia The statute is compulsory. Insurance is required of all employers with three or more employees. Failure to insure is a misdemeanor. There is a penalty of $50 per day. Compensation awarded to the injured worker is increased by 10 percent plus attorneys' fees.

Official Code of Georgia. Section 34-9-1 et. seq.

State Board of Workers Compensation
1000 S. Omni International
Atlanta, GA 30335
(404)656-2034

Hawaii Insurance is required of all employers (*Analysis* chart limits this to employers in industrial employment—a trade, occupation, or profession for profit). Failure to insure is subject to a penalty of $25 or $1 per day per employee, whichever is greater. If the failure lasts for thirty days, the employer may be enjoined from doing business.

Hawaii Revised Statutes. Section 386-1 et. seq.

Disability Compensation Division
Labor & Industrial Relations
830 Punchbowl St.
Honolulu, HI 96813
(808)548-5414

Idaho The statute is compulsory. Insurance is required of all employers. Failure to insure is a misdemeanor. Any officer or employee of a corporation who has authority to procure insurance and fails to do so is also guilty of a misdemeanor and personally liable for compensation and penalties assessed against the corporation. The willful failure to insure is subject to a penalty of $2 per day per employee. After thirty days an employer may be enjoined from doing business (the chart in the *Analysis* also lists a penalty of $1 per day per employee as well as a penalty for defaulting on premiums to the state fund). In addition, an injured worker may receive compensation under the statute plus a 10 percent penalty and costs and attorneys' fees.

Idaho Code. Section 72-101 et. seq.

State Insurance Fund
317 Main St.
Boise, ID 83720
(208)334-2370

Illinois The statute is compulsory. Insurance is required of all employers engaged in the "extra hazardous" activities listed in the statute. Failure to insure is a petty offense. According to the *Analysis*, the fine is from $100 to $500 per day.

Illinois Statutes. Section 138.1 et. seq.

Department of Labor
Alzina Bldg.
100 N. First St., 5th Floor
Springfield, IL 62702
(217)782-6206

Indiana The statute is compulsory. Insurance is required of all employers. Failure to insure is a class A infraction with a fine up to $10,000.

The employer may be enjoined from doing business. An injured employee may be awarded an amount up to double the compensation provided by the statute plus medical expenses and attorneys' fees.

Indiana Code. Section 22-3-1 et. seq.

Industrial Building
601 State Office Bldg.
Indianapolis, IN 46204
(317)232-3808

Iowa The statute is compulsory. Insurance is required of all employers. An employer who fails to insure may be sued by an injured worker. There is a presumption of negligence.

Iowa Code. Chapter 85, 85A, 85B, 86 and 87.

Industrial Community
E. Sixth & Des Moines St.
Des Moines, IA 50319
(525)281-5934

Kansas The statute is compulsory. Insurance is required of all employers. The intentional failure to insure is a class C misdemeanor. According to the *Analysis* an injured worker may pursue legal remedies against the employer.

Kansas Statutes. Section 44-501 et. seq.

Division of Workers' Compensation
Department of Human Resources
217 SE Fourth St., 1st Floor
Topeka, KS 66603
(913)296-3441

Kentucky The statute is compulsory. Insurance is required of all employers. Workers may reject this statute as long as they do so before they are injured. The employer may be enjoined from doing business. If an employer fails to insure, the injured worker may file a claim under the statute and pursue legal remedies.

Kentucky Revised Statutes. Section 342.001 et. seq.

Workers' Compensation Division
Labor Cabinet
The 127 Bldg.
US 127 S.
Frankfort, KY 40601
(502)564-3070

Louisiana The statute is compulsory. Insurance is required of all employers. An employer who fails to insure is liable for the compensation award plus a 12 percent penalty and attorneys' fees.

Louisiana Revised Statutes. Section 23.1021 et. seq.

Office of Workers Compensation
Department of Labor
910 N. Bon Marche Dr.
Baton Rouge, LA 70806
(504)925-4563

Maine The statute is compulsory. Failure to insure is a class D crime. The president or treasurer or both of a corporation that fails to insure are liable for the punishment imposed for a class D crime. An injured worker may elect to sue the employer or to claim compensation under the statute.

Maine Revised Statutes. 39 Sec. 1 et. seq.

Workers' Compensation Commission
State House Station 27
Augusta, ME 04333
(207)289-3751

Maryland The statute is compulsory. Insurance is required of all employers. Failure to insure is a misdemeanor subject to a fine from $500 to $1,000, imprisonment up to one year, or both. The employer may be assessed a penalty equal to six months' premiums due to the state fund if the employer fails to become insured within ten days after being ordered to do so. An employee may elect compensation under the statute or file suit against the employer.

Annotated Code of Maryland. Section 101-1 et. seq.

Workmen's Compensation Commission
6 N. Liberty St., Room 940
Baltimore, MD 21201
(301)659-4775

Massachusetts The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $500, imprisonment up to one year, or both. Failure to insure after conviction is a separate offense. For the corporate employer, the president and treasurer are subject to the same penalty. The injured worker may elect to receive compensation or to sue.

Massachusetts General Laws. 152 Sec. 1 et. seq.

Industrial Accident Board
Executive Office of Economic Affairs
100 Cambridge St., 17th Floor
Boston, MA 02202
(617)727-3400

Michigan The statute is compulsory. Insurance is required of all employers with three or more employees. Failure to insure is subject to a fine of $1,000, imprisonment from thirty days to six months, or both. The employee may sue the employer.

Michigan Compiled Laws. Section 418.161 et. seq.

Bureau of Workers' Disabilities Compensation
Department of Labor
P.O. Box 30016
Lansing, MI 48909
(517)373-3480

Minnesota The statute is compulsory for all employers. Failure to insure is subject to a fine of $100 for employers with fewer than five employees and $400 for employers with five or more employees ($500 or $2,000 for willful or intentional failure to insure). If failure to insure continues, there is an additional penalty equal to five times the lawful premium for that employer. The intentional failure to insure is a gross misdemeanor. If the employee elects to receive compensation under the special fund, the commissioner may pursue the employer for compensation paid plus a 50 percent penalty.

Minnesota Statutes. Section 171.01 et. seq.

Workers Compensation Division
Department of Labor & Industry
444 Lafayette Rd.
St. Paul, MN 55101
(612)296-6490

Mississippi The statute is compulsory. Insurance is required of all employers with five or more employees. Failure to insure is subject to a fine up to $1,000, imprisonment up to one year, or both. The employee may elect to receive compensation or to sue.

Mississippi Code. Section 71-3-1 et. seq.

Workers' Compensation Commission
1428 Lakeland Dr.
Jackson, MS 39216
(601)987-4200

Missouri The statute is compulsory. Insurance is required of all employers with more than five employees. An employee may receive benefits from the second injury fund. The employer will have to reimburse the fund for compensation plus $100 per day the employer remains uninsured after the worker is injured.

Missouri Statutes. Section 287.010 et. seq.

Division of Workers' Compensation
Labor & Industrial Relations Department
722 Jefferson St., Box 58
Jefferson City, MO 65102
(314)751-4231

Montana The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a penalty equal to twice the unpaid premium (not less than $200). The employer may also be subject to an injunction. There is a presumption of negligence. The employee may file a claim under the uninsured employers fund (for which the employer is liable for reimbursement up to $50,000), sue the employer for damages, and has a separate course of action because the employer was uninsured. The uninsured fund has the right to set off against any funds recovered from the uninsured employer or any third party.

Montana Code Annotated. Section 39-71-101 et. seq.

Workers' Compensation Division
Department of Labor & Industry
815 Front St.
Helena, MT 59601
(406)444-6500

Nebraska The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $1,000, imprisonment up to one year, or both. The employer may be enjoined from doing business. The employer may be sued by any injured worker.

Revised Statutes of Nebraska. Section 48-101 et. seq.

Workmens' Compensation Court
13th Floor, State Capitol
P.O. Box 94967
Lincoln, NE 68509-4967
(402)471-2568

Nevada The statute is compulsory. Insurance is required of all employers. Failure to insure is a misdemeanor subject to a fine up to $500 per offense. The employer may be enjoined from doing business. The injured worker may elect to receive compensation or to sue the uninsured employer. Negligence will be presumed.

Nevada Revised Statutes. Section 616.010 et. seq.

State Industrial Insurance System
515 E. Musser St.
Carson City, NV 89710
(702)885-5284

New Hampshire The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a penalty of $500 plus $100 per day per employee. The employer may be subject to an injunction. The employee may sue.

New Hampshire Revised Statutes. Section 281:1 et. seq.

Workmen's Compensation Division
Department of Labor
19 Pillsbury St.
Concord, NH 03301
(603)271-3173

New Jersey The statute is elective. Unless an employer rejects the statute, insurance is required of all employers. Failure to insure is subject to a fine up to $1,000, imprisonment up to sixty days, or both, along with $25 for each ten-day period the employer remains uninsured (up to $100).

New Jersey Statutes. Section 34:15-1 et. seq.

Division of Workers' Compensation
Department of Labor
John Fitch Plaza, CN381
Trenton, NJ 08625
(609)292-2414

New Mexico The statute is compulsory. Insurance is required of all employers with three or more employees. Failure to insure is subject to a fine up to $1,000. The employer may be enjoined from doing business. The employee may sue.

New Mexico Statutes Annotated. Section 52-1-1 et. seq.

Workmen's Compensation Bureau
Labor and Industrial Commission
1596 Pacheco St.
Santa Fe, NM 87501
(505)827-9870

New York The statute is compulsory. Insurance is required of all employers. The first-time offense for failure to insure is subject to a fine from $100 to $500, imprisonment, or both. Repeated offenses can go up to $2,500. There is an additional penalty of $200 for each ten-day period without coverage (up to .5 percent of the payroll for that period). The employer may be sued by the employee.

Consolidated Laws of New York. Workers compensation law.

Workers Compensation Board
180 Livingston St.
Room 600
Brooklyn, NY 11248
(718)802-6666

North Carolina The statute is compulsory. Insurance is required of all employers with four or more employees or whose employees are exposed to radiation where conditions exist that cause said exposure. Failure to insure is subject to a fine of $.10 per day per employee (from $1 to $50). It is also a misdemeanor for which an employer may be fined or imprisoned, or both, at the discretion of the court. The employer is liable to injured workers either for compensation under the statute or in suit in a civil action.

General Statutes of North Carolina. Section 97-1 et. seq.

Industrial Commission
Department of Commerce
430 N. Salisbury St.
Raleigh, NC 27611
(919)733-4820

North Dakota The statute is compulsory. Insurance is required of employers with hazardous working conditions, as defined in the statute. Failure to insure is a misdemeanor subject to a fine of $500, imprisonment for one year, or both. The employer is subject to an injunction and may be sued.

North Dakota Century Code. Section 65-1 et. seq.

Workmen's Compensation Bureau
4007 N. State St.
Bismarck, ND 58501
(701)224-2700

Ohio The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $100 (for willful failure to insure up to $750, imprisonment up to ninety days, or both). The employer may be enjoined against doing business. The employer may also be sued.

Page's Ohio Revised Code Annotated. Section 4123.01 et. seq.

Industrial Commission
246 N. High St.
Columbus, OH 43215
(614)466-3567

Workers' Compensation Bureau
246 N. High St.
Columbus, OH 43215
(614)466-1935

Oklahoma The statute is compulsory. Insurance is required of all employers. The penalty for failure to insure is $1 per day per employee. The employer may be sued by either the injured worker or the administrator of the act.

Oklahoma Statutes Annotated. 85 Sec. 1 et. seq.

Workers' Compensation Court
2101 N. Lincoln Blvd.
Oklahoma City, OK 73105
(405)521-8025

Oregon The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to an initial penalty up to $1,000. If an employer fails to become insured after being ordered to do so, the employer may also be fined up to $25 per day. If an employee is injured while the employer is uninsured, there is an additional penalty not less than $100 nor more than $5,000 (depending on the type of injury). The injured worker must file a claim for compensation under the statute. This claim is paid out of the Industrial Accident Fund. The employer is liable for the cost of compensation, reasonable administrative fees, and attorneys' fees awarded the employee.

Oregon Revised Statutes. Section 656.001 et. seq.

Workers' Compensation Department
200 Labor & Industries Bldg.
Salem, OR 97310
(503)378-3304

Pennsylvania The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine from $500 to $2,000, imprisonment up to one year, or both. Each day is considered a separate offense. The employee may elect to receive compensation under the statute or to sue the employer.

Pindon's Pennsylvania Statutes Annotated. Chapter 77.

Bureau of Worker's Compensation
Department of Labor & Industry
3607 Derry St., 4th Floor
Harrisburg, PA 17120
(717)783-5421

Rhode Island The statute is compulsory. Insurance is required of all employers engaged in hazardous occupations as defined under the statute, or with four or more employees. Failure to insure is subject to a fine up to $1,000, imprisonment up to one year, or both. Corporate officers are personally liable for compensation while the corporation is uninsured. The employer may be sued.

General Laws of Rhode Island. Section 28-36-1 et. seq.

Workers' Compensation Commission
One Dorrance Plaza
Providence, RI 02903
(401)277-3097

South Carolina The statute is elective. Unless the statute is rejected, insurance is required of all employers with four or more employees. Failure to insure is subject to a fine of $.10 per day per employee (minimum $1, maximum $50 per day). If failure to insure lasts thirty days the employer may be subject to an injunction. The willful failure to insure is a misdemeanor subject to a fine up to $1,000, imprisonment from thirty days to six months, or both. The employer may also be sued.

Code of South Carolina. Title 42.

Industrial Commission
1800 St. Julian Pl.
Columbia, SC 29204
(803)758-3880

Workmen's Compensation Fund
800 Dutch Sq. Blvd.
Building C, No. 160
Columbia, SC 29210
(803)758-6500

South Dakota Although the *Analysis* indicates that this statute is compulsory, it appears to be elective. Any employer who fails to insure is deemed to have elected not to operate under the statute. The employer may be sued. There is no civil fine or criminal penalty for the failure to insure.

South Dakota Codified Laws. Title 62.

Division of Labor and Management
Department of Labor
Kneip Bldg.
Pierre, SD 57501
(605)773-3681

Tennessee The statute is compulsory. Insurance is required of employers with five or more employees. Failure to insure is subject to a fine from $10 to $100. If the failure continues, the fine is from $1 to $10 per day for each day of continued noncompliance. The employee may elect compensation under the statute or file suit against the employer.

Tennessee Code Annotated. Section 50-6-1 et. seq.

Department of Labor
501 Union Bldg.
Nashville, TN 37219
(615)741-2395

Texas The statute is elective. Insurance is required of employers who accept the statute. There is no penalty for the failure to insure. However, the injured worker may sue the employer.

Vernon's Annotated Civil Statutes. Articles 8306 to 8309.

Division of Workers' Compensation
Office of Attorney General
314 Highland Mall Blvd., No. 350
Austin, TX 78752
(512)475-6040

Utah The statute is compulsory. Insurance is required of all employers. Any employer, including officers, that fails to insure is guilty of a class B misdemeanor. Each day is a separate offense. The employer is subject to a fine up to $1,000 if an individual, up to $5,000 if some sort of business entity. The employer is also subject to imprisonment from thirty days to six months. The injured worker may elect compensation under the statute or file suit against the employer.

Utah Code Annotated. Section 35-1-1 et. seq.

Workmen's Compensation Division
160 E. 300 St.
P.O. Box 5800

Salt Lake City, UT 84110-5800
(801)530-6811

Vermont The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $100 per day if insurance is not provided within thirty days after notice to the employer.

Vermont Statutes Annotated. Title 21, Sections 601 to 710.

Department of Labor and Industry
7 Court St.
Montpelier, VT 05602
(802)828-2186

Virginia The statute is compulsory. Insurance is required of all employers with more than three employees (if the employer is a farm, more than two full-time employees). Failure to insure is subject to a fine from $50 to $1,000. The intentional failure is a class 2 misdemeanor. The employer may be subject to an injunction. The injured worker may sue the employer instead of seeking compensation under the statute. If the employer has failed to insure, the traditional common-law defenses are not available.

Code of Virginia. Section 65.1-1 et. seq.

Department of Workmen's Compensation
1000 Department of Motor Vehicles Dr.
Richmond, VA 23220
(804)257-8633

Washington The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a penalty equal to an amount between 50 percent and 100 percent of the cost of any injury or occupational disease along with an additional penalty of $500 or double the amount of unpaid premiums, whichever is greater. If the failure to insure is intentional, the employer is subject to a fine from $25 to $100 for each day there is no insurance. The employer may also be required to furnish a double bond and is subject to an injunction.

Revised Code of Washington Annotated. Title 51.

Department of Labor and Industries
General Administration Bldg.
M/S AX-31
Olympia, WA 98504
(206)753-6307

West Virginia The statute is compulsory. Insurance is required of all employers. There is no criminal penalty for failure to insure unless the failure to insure was intentional; then the employer is subject to a fine up to $5,000. If an employee collects compensation under the statute, the employer is liable to the state fund for past premiums plus interest and reimbursement of all claims paid by the fund on the employer's behalf.

West Virginia Code. Chapter 23.

Workers' Compensation Commission
P.O. Box 3051
Charleston, WV 25332
(304)344-2580

Wisconsin The statute is compulsory. Insurance is required of all employers who pay more than $500 in wages in any calendar quarter (or for farmers with more than six employees). Failure to insure is subject to a fine from $10 to $100 or imprisonment from thirty days to six months (each day is a separate offense). The employer may be subject to an injunction.

Wisconsin Statutes Annotated. Section 102.01 et. seq.

Division of Worker's Compensation
Industry, Labor and Human Relations Department
P.O. Box 7901
Madison, WI 53707
(608)266-6827

Wyoming The statute is compulsory. Insurance is required of employers engaged in "extra hazardous" occupations for profit. These occupations include fifty-four specific items defined at section 27-12-106 of the statutes. Failure to insure is subject to a fine up to $500 plus 10 percent of premiums due. The employer may also be subject to an injunction and can be sued by an injured employee.

Wyoming Statutes Annotated. Section 27-12-101 et. seq.

Workers' Compensation Division
Office of State Treasurer
122 W. 25th St.
Cheyenne, WY 82002
(307)777-7441

District of Columbia The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $1,000 or imprisonment up to one year, or both.

District of Columbia Code. Sec. 36-301 et. seq.

Office of Workers Compensation
Department of Employment Services

1200 Upshur St., NW, 3d Floor
Washington, DC 20011
(202)576-6265

American Samoa The statute is compulsory. Insurance is required of all hazardous employment and for all employers with three or more employees. Failure to insure is subject to a fine up to $1,000, or imprisonment up to one year, or both. The employer may also be sued.

Workmen's Compensation Commission
Legal Affairs
Pago Pago, AS 96799
(684)633-5520

Guam The statute is compulsory. Insurance is required of all employers engaged in a trade, occupation, or profession for profit. Failure to insure is subject to a fine up to $1,000, imprisonment up to one year, or both. The employer may be sued and must reimburse the state for compensation paid to the injured worker.

Department of Labor
P.O. Box 23548
GFM, GU 96921
(671)646-9241

Puerto Rico The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine from $25 to $1,000, imprisonment up to six months, or both. There is an additional penalty equal to 30 percent of the compensation paid out (not less than $10). The employer may also be sued.

Laws of Puerto Rico Annotated. Title 11.

Puerto Rico Industrial Commission
G.P.O. Box 4466
San Juan, PR 00936
(809)781-0615
(809)783-3808

Virgin Islands The statute is compulsory. Insurance is required of all employers. Failure to insure is subject to a fine up to $500, imprisonment up to six months, or both as well as interest on past-due premiums. The employer is liable for compensation, expenses, and a 30 percent penalty of the total and may be sued by the injured employee.

Workmen's Compensation Division
Department of Labor
P.O. Box 148
St. Thomas, VI 00801
(809)775-5747

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APPENDIX: Occupational Safety— State Agencies and Addresses

(Enforce safety standards for the protection of employees in places of employment.)

ALABAMA
Dept. of Labor
64 N. Union St., Rm. 600
Montgomery, AL 36130
(205)261-3460

ALASKA
Occupational Safety & Health
Dept. of Labor
P.O. Box 1149
Juneau, AK 99802
(907)465-4855

ARIZONA
Occupational Safety & Health
Industrial Comm.
P.O. Box 19070
Phoenix, AZ 85007
(602)255-5795

ARKANSAS
Dept. of Labor
1022 High St.
Little Rock, AR 72202
(501)375-8442

CALIFORNIA
Occupational Safety & Health
Dept. of Industrial Relations
525 Golden Gate Ave.
San Francisco, CA 94102
(415)557-1946

CONNECTICUT
Occupational Safety & Health
Dept. of Labor
200 Folly Brook Blvd.
Wethersfield, CT 06109
(203)566-4550

DELAWARE
Div. of Industrial Affairs
Dept. of Labor
820 N. French St.
Wilmington, DE 19801
(302)571-2877

FLORIDA
Div. of Workers' Compensation
Labor & Employment Security Dept.
200 Ashley Bldg.
Tallahassee, FL 32301
(904)488-5681

GEORGIA
Field Services
Dept. of Labor
254 Washington St., SW
Atlanta, GA 30334
(404)656-3014

HAWAII
Occupational Safety & Health Div.
Labor and Industrial Relations Dept.
677 Ala Moana Blvd., Suite 910
Honolulu, HI 96813
(808)548-4155

IDAHO
Labor & Industrial Services Dept.
317 Main St.
Boise, ID 83720
(208)334-3950

ILLINOIS
Ill. Public Employees Health & Safety Program
Dept. of Labor
100 N. First St.
Springfield, IL 62706
(217)782-6206

INDIANA
Div. of Labor
1013 State Off. Bldg.
Indianapolis, IN 46204
(317)232-2663

IOWA
Bur. of Labor
307 E. Seventh St.
Des Moines, IA 50319
(515)281-3606

KANSAS
Labor-Mgt. Relations
Dept. of Human Resources
512 SW Sixth St., 1st Fl.
Topeka, KS 66603
(913)296-7475

KENTUCKY
Occupational Safety & Health
Labor Cabinet
The 127 Bldg.
U.S. 127 S.
Frankfort, KY 40601
(502)564-2300

LOUISIANA
Off. of Labor
Dept. of Labor
P.O. Box 94094
Baton Rouge, LA 70804-9094
(504)925-4221

MAINE
Bur. of Labor Standards
Dept. of Labor
State House Station 45
Augusta, ME 04333
(207)289-3331

MARYLAND
Occupational Safety & Health
Licensing and Regulation Dept.
501 St. Paul Pl.
Baltimore, MD 21202-2272
(301)659-4195

MASSACHUSETTS
Div. of Industrial Safety
Dept. of Labor & Industries
100 Cambridge St.
Boston, MA 02202
(617)727-3567

MICHIGAN
Bureau of Safety & Regulation
Dept. of Labor
P.O. Box 30015
Lansing, MI 48909
(517)322-1814

MINNESOTA
Occupational Safety & Health Admn.
Dept. of Labor & Industry
444 Lafayette Rd.
St. Paul, MN 55101
(612)296-2116

MISSISSIPPI
Occupational Safety & Health
Dept. of Health
4443 I-55 N.
Jackson, MS 39211
(601)982-6315

MISSOURI
Div. of Labor Standards
Labor & Industrial Relations Dept.
P.O. Box 449
Jefferson City, MO 65102
(314)751-3403

MONTANA
Safety & Health Bur.
Dept. of Labor & Industry
510 Logan St.
Helena, MT 59601
(406)444-6401

NEBRASKA
Div. of Safety
Dept. of Labor
P.O. Box 95024
Lincoln, NE 68509
(402)471-2239

NEVADA
Occupational Safety & Health
Dept. of Industrial Relations
1370 S. Curry St.
Carson City, NV 89710
(702)885-5240

NEW HAMPSHIRE
Dept. of Labor
19 Pillsbury St.
Concord, NH 03301
(603)271-3171

NEW JERSEY
Workplace Standards
Dept. of Labor
John Fitch Plaza, CN386
Trenton, NJ 08625
(609)292-2313

NEW MEXICO
Occupational Health & Safety
Dept. of Health & Environment
P.O. Box 968
Santa Fe, NM 87504-0968
(505)827-8948

NEW YORK
Dept. of Labor
Campus, State Off. Bldg.
Albany, NY 12240
(518)457-2741

NORTH CAROLINA
Dept. of Labor
214 W. Jones St.
Raleigh, NC 27603
(919)733-7166

NORTH DAKOTA
Workmen's Compensation Bur.
4007 N. State St.
Bismarck, ND 58501
(701)224-2700

Safety Dept.
Workmen's Compensation Bur.
4007 N. State St.
Bismarck, ND 58501
(701)224-2700

OHIO
Div. of Safety & Hygiene
Industrial Comm.
246 N. High St.
Columbus, OH 43215
(614)466-3564

OKLAHOMA
Safety Standards Div.
Dept. of Labor
118 State Capitol
Oklahoma City, OK 73105
(405)521-2461

OREGON
Accident Prevention Div.
Dept. of Workers' Compensation
204 Labor & Industries Bldg.
Salem, OR 97310
(503)378-3272

PENNSYLVANIA
Occupational & Industrial Safety
Dept. of Labor & Industry
1529 Labor & Industry Bldg.
Harrisburg, PA 17120
(717)787-3323

RHODE ISLAND
Occupational Safety & Health
Dept. of Labor
220 Elmwood Ave.
Providence, RI 02907
(401)277-2756

SOUTH CAROLINA
Occupational Safety & Health
Dept. of Labor
P.O. Box 11329
Columbia, SC 29211
(803)758-3080

TENNESSEE
Dept. of Labor
501 Union Bldg.
Nashville, TN 37219
(615)741-2793

TEXAS
Div. of Occupational Safety
Dept. of Health
1100 W. 49th St.
Austin, TX 78756
(512)458-7111

UTAH
Occupational Safety & Health Div.
Industrial Comm.
160 E. 300 St.
Salt Lake City, UT 84110-5800
(801)530-6901

VERMONT
Occupational & Safety Health Admin. Div.
Dept. of Labor & Industry
5 Court St.
Montpelier, VT 05602
(802)828-2765

VIRGINIA
Dept. of Labor & Industry
205 N. Fourth St.
Richmond, VA 23219
(804)786-2376

WASHINGTON
Industrial Safety & Health
Dept. of Labor & Industries
814 E. Fourth Ave.
Olympia, WA 98504
(206)753-6308

WEST VIRGINIA
Dept. of Labor
State Capitol Complex
Bldg. 3
Charleston, WV 25305
(304)348-7890

WISCONSIN
Div. of Safety & Buildings
Industry, Labor & Human Relations
P.O. Box 7969
Madison, WI 53707
(607)266-1816

WYOMING
Occupational Health & Safety Comm.
604 E. 25th St.
Cheyenne, WY 82002
(307)777-7787

DISTRICT OF COLUMBIA
Occupational Safety & Health
Dept. of Employment Services
950 Upshur St., NW
Washington, DC 20011
(202)576-6651

AMERICAN SAMOA
Occupational Safety & Loss Prevention
Administrative Services Dept.
Pago Pago, AS 96799
(684)633-2237

GUAM
Dept. of Labor
P.O. Box 23548
GMF, GU 96921
(671)646-9241

NORTH MARIANA ISLANDS
Dept. of Commerce & Labor
Off. of the Governor
Saipan, CM 96950
(011)670-7261

PUERTO RICO
Dept. of Labor & Human Resources
505 Munoz Rivera Ave.
Hato Rey, PR 00918
(809)754-5353

VIRGIN ISLANDS
Occupational Safety and Health
Dept. of Labor
Lagoon Complex, Frederiksted
St. Croix, VI 00840
(809)772-1315

UNEMPLOYMENT INSURANCE

UNEMPLOYMENT INSURANCE

1. INTRODUCTION

1.1 Background

Unemployment insurance provides income to people who have lost their jobs through no fault of their own and who are actively seeking suitable employment—a concept many states apply quite liberally. In theory, unemployment insurance spreads the cost of unemployment equitably among many employers.

Unemployment insurance is designed to provide a means of support to people who have involuntarily left the labor force and are actively attempting to return.

1.2 Federal–State Interaction

The Federal Unemployment Tax Act (FUTA) levies a tax against wages paid to employees and allows a credit to the employer of up to 90 percent of the tax owed. For 1988, the tax is 6.2 percent of wages up to $7,000. Employer credit for tax paid to state unemployment funds is as much as 5.4 percent of taxable wages. Amounts paid to unemployment insurance funds are used to fund claims and pay administrative expenses. The federal portion is used to make advances to states that run short of funds in their own unemployment insurance system, advances that states must repay.

2. DEFINITIONS

Employer

— Any person or organization that during the current or preceding year either (a) paid wages of $1,500 or more in any calendar quarter, or (b) had one or more employees at any time in each of any twenty calendar weeks.

— Any agricultural employer who during the current or preceding year either (a) paid cash wages of $20,000 or more for farm labor in any calendar quarter, or (b) employed ten or more farm workers at any time for at least one day during any twenty different weeks.

— Any household employer who during the current or preceding year paid cash wages of at least $1,000 during any calendar quarter for household services in a private home, local college club, or fraternity/sorority.

Employee. An individual who performs services under the direction and control of an employer.
Successor employer. One who acquires substantially all the property used in a trade or business of another employer and who employs in the trade or business a substantial majority of the same individuals employed by the preceding employer.
Common paymaster. Any member of a group of related corporations that disburses remuneration to employees of two or more of those corporations and is responsible for keeping books and records for those employees.
Normal or 90 percent credit. Credit that allows an employer to use the state unemployment insurance contribution as an offset against the greater portion (90 percent) of the federal unemployment tax liability.
Additional credit. Credit against an employer's federal unemployment tax liability equal to the difference between the amount of contributions actually paid to the state and the amount that would have been required to be paid if a reduced experience rating had not been obtained.
Experience rating. The method by which employer contributions under the state unemployment compensation laws may be varied on the basis of each individual employer's experience with unemployment. Also called *merit rating.*
Voluntary contribution. Contribution to the state unemployment fund by an employer to achieve a better experience rating. The contribution is allowed as an offset against benefits charged to the employer's account.

3. FEDERAL UNEMPLOYMENT TAX ACT (FUTA)

3.1 Purpose

The Federal Unemployment Tax Act is designed to provide unemployment compensation to workers who have lost their jobs through layoff, reduction in labor force, or other reasons beyond their control.

3.2 Covered Employment

All employment is considered to be covered employment except as described in section 3.8.

3.3 Successor Employer

A successor employer acquires substantially all the property used in another employer's trade or business and continues to employ the same individuals. The successor employer

— May count the wages paid by the first employer during the current year in figuring the $7,000 wage limit.
— Is not subject to pass the twenty-weeks or $1,500-wages-in-a-calendar-quarter test. Since the first employer has already met these tests, the successor employer is automatically liable.

The manner of acquisition is immaterial. All the following situations result in successor employers:

— Purchase of trade or business
— Incorporation of previously unincorporated trade or business
— Continuation of an existing partnership by a new partnership

3.4 Statutory Merger

A statutory merger or consolidation does not result in successor employers. No adverse tax effect results either, since the new entity following the merger or consolidation is considered the same employer and taxpayer as the previous employer. The new employer may thus consider wages paid by the absorbed entity as having been paid by it (the new employer) when computing FUTA tax.

3.5 Credit for Successor Employers

A successor employer may not count wages paid by a predecessor who did not qualify as an employer under the Federal Unemployment Tax Act. However, a credit is allowed against the successor's FUTA tax based on the percentage of employees retained by the successor employer.

> *Example*: Jones Partnership sells to Smith, Inc. all its property before Jones has met employer qualifications under the Federal Unemployment Tax Act. Smith retains 20 percent of Jones' employees, representing 20 percent of total wages paid. Smith cannot count the wages paid by Jones when figuring the $7,000 wage limit. Instead, Smith is entitled to a credit against its FUTA tax based on the amount of credit Jones could have claimed for the employees retained by Smith if Jones had qualified as an employer. If Jones could have claimed a $1,000 credit against its FUTA tax liability, Smith is entitled to claim a $200 credit since it retained 20 percent of Jones' employees.

3.6 Common Paymaster

Related corporations with a common paymaster who have employees working for all the corporations do not have to pay FUTA tax on the first $7,000 of wages paid to each employee by each of the related corporations.

Example: Bill Doe works for two related corporations—Red, Inc. and Blue, Inc. Doe earns $25,000 annually from Red, Inc. and $25,000 from Blue, Inc. He devotes his time equally between the two corporations. Red, Inc. is the common paymaster, so the corporations are treated as one employer. Therefore FUTA tax is calculated on only $7,000 of Doe's wages, not on $14,000.

3.7 Corporations Entitled to Use Common Paymaster

Three criteria must be met to qualify for this special treatment:

— *Related corporations.* Corporations that meet any one of the following tests are considered related:

The corporations are members of a "controlled group of corporations" as defined in Internal Revenue Code Section 1563.

Fifty percent of the board of directors of a corporation that does not issue stock are members of the other corporation's board of directors.

Fifty percent or more of one corporation's officers are concurrently officers of the other corporation.

Thirty percent or more of one corporation's employees are concurrently employees of the other corporation.

— *Common paymaster.* The common paymaster is not required to pay every one of the employees of the related corporations. But, for the special provision described in the example to apply, the particular employees' wages must be disbursed through a common paymaster. The remuneration may be paid by one combined paycheck drawn on one account or by separate paychecks drawn on different accounts.

— *Concurrent employment.* Employees must perform services for the benefit of the employing corporation in exchange for remuneration contemporaneously from two or more corporations.

3.8 Exemptions

Employers described in section 2 are subject to FUTA tax except for:

— Agricultural employment when total wages paid by the employer are less than $20,000 in a quarter or the employer does not employ ten or more employees on twenty days in different weeks.

— Domestic service when the employer pays wages less than $1,000 in any calendar quarter in the current or preceding year.

— Service not in the course of the employer's trade or business unless wages equal or exceed $50 and work is performed by an individual regularly employed to perform such services.

— Employment of child or spouse, or child under twenty-one in employ of parent.

— Employment by U.S. government or instrumentality of the United States owned in whole or in part by the United States, or exempt under FUTA Section 3301.

— Employment by a state political subdivision or instrumentality owned in whole or in part by the state.

— Service in employ of religious, charitable, educational, or other institution exempt from tax under 501(a) unless that institution employs four or more employees.

— Employment under the Railroad Unemployment Insurance Act.

— Students enrolled in a college or university employed at same.

— Work study.

— Service performed in hospital by a patient.

— Service performed in the employ of a foreign government or in the employ of an instrumentality wholly owned by a foreign government.

— Student nurses or interns in the employ of a hospital or training school.

— Insurance agents paid wholly by commission.

— Individuals under eighteen with paper routes.

— Employment by an international institution.

— Employment for commercial fishing.

— Nonimmigrants under worker's visas.

— Full-time students employed by a camp.

3.9 Tax Rate

The 1988 gross FUTA tax rate is 6.2 percent of the taxable wages paid during a calendar year. Employers receive a credit against their FUTA tax liability for contributions made to their state fund. The maximum credit is limited to 90 percent of a deemed 6 percent federal tax rate, or 5.4 percent. The net FUTA tax rate for many employers is .8 percent.

A reduction in the net federal unemployment rate from 0.8 percent to 0.6 percent was to occur January 1, 1988. However, an extension of the 0.8 percent rate was made until January 1, 1991, when the rate is scheduled to decrease to 0.6 percent.

3.10 Covered Earnings

Employers are liable for FUTA tax on the first $7,000 paid to each employee during a calendar year.

3.11 Compliance

Penalties, fines, interest, and levies are imposed upon employers who do not comply with FUTA tax rules.

3.11.1 Penalties and interest

— A 10 percent penalty of the amount of any underpayment is imposed when a deposit is untimely.

— A 25 percent penalty is charged when deposits are overstated (amounts claimed on Form 940 as having been deposited that exceed the amount actually deposited by the date the return is filed).

— Bad checks result in a penalty of the greater of 1 percent of the amount of the check or a flat $5 if the check is for $500 or less.

— A 5 percent penalty of the net tax to be reported is imposed per month up to a maximum penalty of 25 percent for each month or part of a month that employment tax returns are late.

— A penalty of half of 1 percent up to 25 percent of the tax due is imposed for each month during which the failure to pay continues.

— Criminal penalties, in addition to the penalties previously listed, of imprisonment and fines of up to $10,000 will be imposed when a willful attempt to evade payment of employment taxes by failing to file the federal unemployment tax form (Form 940) or by filing a false return is made.

Taxes due and unpaid will bear interest at the current federal rate, compounded daily.

3.11.2 Levies

The IRS may authorize a levy on and seize property and property rights of an employer if the employer fails to pay any tax liability within ten days after notice and demand for payment.

3.12 Deposit Requirements

Employers must compute their FUTA tax liability quarterly as follows: FUTA Taxable Wages × Net FUTA Tax Rate = FUTA Tax Liability

(Text continued on page 93)

3.12.1 Deposit rules

- If the aggregate quarterly undeposited FUTA tax liability is more than $100, a deposit of the tax must be made by the due date.
- If in any of the first three quarters the FUTA tax liability is under $100, the liability is carried over to the next quarter and added to that quarter's liability.
- If fourth-quarter FUTA tax liability is over $100, the liability must be deposited by January 31 of the following year.
- If the FUTA tax liability for the fourth quarter is under $100, it may be remitted directly to the IRS with Form 940.
- If the employer wishes to receive a ten-day extension of the due date for Form 940, all FUTA tax must be deposited by January 31 of the following year, even if the liability is less than $100.

3.12.2 Where and how to deposit

Form 8109, Federal Tax Deposit Coupon, is used to make deposits of FUTA tax. Deposits are to be made at a Federal Reserve bank or an authorized depository. Deposits made by mail should be by check or money order payable to the depository bank. The date of receipt will determine the timeliness of the deposit. A deposit received after the due date will still be considered timely if the employer can establish that it was mailed on or before the second day before the due date.

3.12.3 Deposit due dates

When an FUTA tax deposit is required, it is due the last day of the month following the end of the quarter (April 30, July 31, October 31, and January 31). If the due date falls on a Saturday, Sunday, or legal holiday, the due date becomes the next business day.

4. REPORTING REQUIREMENTS UNDER FUTA

All employers subject to FUTA tax during a calendar year must file an annual return on Form 940, Employer's Annual Federal Unemployment Tax Return.

4.1 Who Must File

- If there is a change of ownership or transfer of business during the year, each employer who qualifies as an employer under FUTA requirements must file Form 940 reporting the wages paid during the year.

— If there is a statutory merger or consolidation, the resulting corporation is considered the same employer and only one Form 940 must be filed.

— If a successor-predecessor relationship exists and the predecessor was not an employer under FUTA requirements, the successor, if considered an employer under FUTA requirements, must file Form 940 for the portion of the year following acquisition of the business.

4.2 Filing Due Date

Form 940 is due on or before January 31 of the following year. If the employer has made timely deposits and the FUTA liability is paid in full, Form 940 will receive an automatic ten-day extension until February 10 of the following year. If the due date falls on a Saturday, Sunday, or legal holiday, Form 940 is due the next business day.

A mailed return bearing a postmark indicating that it was mailed on or before the due date will be considered timely filed. The registration date of a return sent by registered mail will be considered the postmark. If a return is sent by certified mail, the postmark date on the employer's receipt is considered the postmark date.

4.3 Signing Form 940

The return should be signed by:

Type of Entity	Signer
Sole proprietorship	Individual
Corporation	Principal officer
Partnership or unincorporated organization	Partner or officer
Trust or estate	Fiduciary of trust or estate

An unsigned Form 940 will not be considered a return.

4.4 Where to File Form 940

The completed Form 940 should be sent to the IRS center of the region in which the employer's principal place of business or office or agency is located. Below is a list of regions, states included within them, and addresses.

If your legal residence, principal place of business, office, or agency is located in	*Use this Internal Revenue Service Center address*
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA 39901
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	Holtsville, NY 11742
New York (all other counties), Connecticut, Maine, Massachusetts, Minnesota, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO 64999
Delaware, District of Columbia, Maryland, Pennsylvania, Puerto Rico, Virgin Islands	Philadelphia, PA 19255
Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake,	

(continued on p. 12)

(Text continued on page 96)

Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Arkansas, Indiana, North Carolina, Tennessee, Virginia	Memphis, TN 37501
If you have no legal residence or principal place of business in any IRS district	Philadelphia, PA 19255

5. FUTA AND STATE UNEMPLOYMENT INSURANCE

Two types of credit are applicable against the FUTA tax for contributions made to state unemployment agencies—normal (or 90 percent) credit and additional credit.

5.1 The "Normal" or "90 Percent" Credit

The Federal Unemployment Tax Act permits an employer to offset against the FUTA tax liability 90 percent of the FUTA tax. This credit is only allowed to employers whose state laws require state unemployment contributions and only if the contributions are actually paid by the employer in the year in which the credit was claimed.

Although the FUTA gross tax rate is 6.2 percent, only 90 percent of a deemed 6 percent federal tax rate is allowed. The 0.2 percent difference will continue in effect until January 1, 1991, when the rate is scheduled to decrease to 6 percent.

Example: An employer is subject to both federal and state unemployment tax. The taxable payroll for both laws is $50,000. The state contribution rate is 2.9 percent, so the state tax liability is $1,450 ($50,000 × 2.9%). The federal tax liability before deducting the 90 percent credit is $3,100 ($50,000 × 6.2%). The employer may take a credit of $2,700 ($50,000 × 6% × 90%) against the federal tax. The net federal tax is $400 ($3,100 − $2,700).

5.2 Requirements to Qualify for 90 Percent Credit

The total credit against federal tax for a calendar year may not exceed 90 percent of 6 percent, including the 90 percent credit and the additional credit described in section 5.3. The lowest net federal tax rate therefore cannot be lower than .8 percent (6.2 percent less 5.4 percent).

The full 90 percent credit applies only if all state contributions are paid on or before the due date of the federal return. A partial credit is allowed for the amount of state contributions paid after the due date. This partial credit is limited to 90 percent of the amount that would have been allowed if the state contributions had been timely made. The partial credit would be 81 percent (90 percent of 90 percent) of the federal tax.

5.3 Additional Credit

For an employer who had obtained a good experience rating the amount paid for state contributions would be considerably less than 90 percent of the deemed federal rate (5.4 percent). In this case there would not be any benefit in a favorable rating, since the employer would be paying considerably more in FUTA tax.

For this reason an additional credit is allowed. The federal government allows the employer to take an additional credit against the federal tax equal to the difference between the contributions actually paid to the state and the amount that would have been paid if the reduced rate had not been in effect.

5.4 State Loans and Shortages

Title XII of the Social Security Act allows a state to borrow funds from the federal unemployment account to enable the state to pay unemployment benefits. This allows a state to continue to pay benefits when its funds run low because of poor economic conditions. Repayment of this loan, without interest, can occur in three ways:

— A reduction of the state's share of the amount of any excess in the employment security administration account that would have been transferred to the state's account in the unemployment trust fund.

— A transfer of funds from the state's account in the unemployment trust fund to the federal unemployment account.

— A reduction in the total credit otherwise allowed an employer.

This reduction of the credit against federal tax is computed on Part 1 of Form 940. Each quarter the employer should compute the federal tax liability, using the net FUTA rate. The credit reduction is not computed and paid until Form 940 is filed.

> *Example*: Blake, Inc. has a net FUTA rate of .8 percent. Taxable wages for the calendar year were $100,000, or $25,000 per quarter. For the first three quarters, Blake should deposit $200 ($25,000 × .8%). The state Blake resides in has a .9 percent credit reduction. Blake's fourth-quarter FUTA deposit is calculated as follows:
>
> Fourth-Quarter Taxable Wages $25,000
> Net FUTA Rate × .8%
> Fourth-Quarter FUTA Tax $200
> Credit Reduction
> Total Taxable Wages for the Year $100,000
> Credit Reduction Rate × .9%
> Additional FUTA Tax $900
> Deposit Due January 31 $1,100

6. STATE UNEMPLOYMENT INSURANCE

All states have unemployment compensation laws that require contributions from employers. Some states require contributions from employees. Each state is responsible for the content and development of its unemployment insurance laws.

Each state governs

— Amount and duration of benefits, with minor limitations.

— Coverage and contribution rates.

— Eligibility requirements and disqualification provisions.

— Direct administration of the laws, including collecting contributions, maintaining wage records, taking claims, determining eligibility, and paying benefits.

6.1 Experience Rating

Experience ratings allow employer state contribution rates to vary based on the employer's experience with unemployment. Experience ratings permit the cost of unemployment compensation to vary depending on an employer's rate of involuntary unemployment. As a result of experience ratings, state contribution rates range from the lowest rate allowed of 0 to rates that exceed 5.4 percent. All states are required to provide for experience ratings up to at least 5.4 percent because of the federal credit of 5.4 percent (6% × 90%).

6.2 Determination of Experience Rating

All formulas for calculating an experience rating are devised to determine the experience of each employer with unemployment or benefit costs. This list indicates the type of plan used to determine experience ratings as of August 1, 1987:

	Experience Rating
Alabama	Benefit-wage ratio
Alaska	Payroll decline
Arizona	Reserve ratio
Arkansas	Reserve ratio
California	Reserve ratio
Colorado	Reserve ratio
Connecticut	Benefit ratio
Delaware	Benefit-wage ratio
District of Columbia	Reserve ratio
Florida	Benefit ratio
Georgia	Reserve ratio
Hawaii	Reserve ratio
Idaho	Reserve ratio
Illinois	Benefit-wage ratio
Indiana	Reserve ratio
Iowa	Benefit ratio
Kansas	Reserve ratio
Kentucky	Reserve ratio
Louisiana	Reserve ratio

Experience Rating *(Continued)*

Maine	Reserve ratio
Maryland	Benefit ratio
Massachusetts	Reserve ratio
Michigan	Benefit ratio
Minnesota	Benefit ratio
Mississippi	Benefit ratio
Missouri	Reserve ratio
Montana	Reserve ratio
Nebraska	Reserve ratio
Nevada	Reserve ratio
New Hampshire	Reserve ratio
New Jersey	Reserve ratio
New Mexico	Reserve ratio
New York	Reserve ratio
North Carolina	Reserve ratio
North Dakota	Reserve ratio
Ohio	Reserve ratio
Oklahoma	Benefit-wage ratio
Oregon	Benefit ratio
Pennsylvania	Benefit ratio and reserve ratio
Puerto Rico	None
Rhode Island	Reserve ratio
South Carolina	Reserve ratio
South Dakota	Reserve ratio
Tennessee	Reserve ratio
Texas	Benefit ratio
Utah	Benefit ratio
Vermont	Benefit ratio
Virgin Islands	Benefit ratio
Virginia	Benefit ratio
Washington	Benefit ratio
West Virginia	Reserve ratio
Wisconsin	Reserve ratio
Wyoming	Benefit ratio

6.3 Reserve-Ratio Formula

An account for each employer shows total payroll, employer contributions, and benefits paid to workers. Benefits are subtracted from contributions. The net amount is then divided by total payroll to determine the size of the balance in terms of potential liability. While a balance of $5,000 may be adequate for a total payroll of $50,000, it would be low for a total payroll of $200,000.

The size of an employer's reserve ratio determines the experience rating. The larger the reserve ratio, the lower the experience rating. The formula is designed to give a better experience rating to those employers who have contributed more than benefits paid out.

6.4 Benefit-Ratio Formula

This formula compares benefits to payrolls. The basis for this formula is the fact that if each employer pays a rate that meets the benefit ratio the program will be adequately funded.

6.5 Benefit-Wage-Ratio Formula

This experience rating is measured by separations of workers that result in the payment of benefits; the duration of their benefits is not considered. The separations are weighted with the workers' wages earned from each base-period employer and are recorded on each employer's experience rating record. These wages are termed *benefit wages.* For any one employer, only one separation per beneficiary per benefit year is recorded on the record.

The experience of each employer is determined by dividing the total benefit wages into the total taxable wages. This experience factor is then multiplied by the state's experience factor. A table is then used to determine the experience rate.

6.6 Payroll-decline Formula

This experience rating formula is measured by the decline in an employer's payrolls from year to year or quarter to quarter. No benefit or contribution amounts are considered. This formula operates on the assumption that if an employer's payroll declines, the employer is not offering as much employment and is therefore considered a source of potential unemployment.

7. FACTORS AFFECTING EMPLOYER'S EXPERIENCE RATING

Certain factors affect an employer's experience rating. Among these are benefit charges, seasonal workers, voluntary contributions and successor employer situations.

7.1 Benefit Charges

When an employee receives unemployment benefits, those benefits either have to be charged to the state's fund or to the employer or employers who had paid wages to the employee for which the benefits were received. In reserve-ratio and benefit-ratio states, a claimant's benefits need to be charged. In benefit-wage states the benefit wages need to be charged. There is no charging of benefits in payroll-decline states.

There are three methods of charging benefits to employers.

7.1.1 Charging most-recent employers

A few states charge the most-recent employer on the theory that this particular employer is primarily responsible for the unemployment. In most of these states the charges are limited to the most-recent employer who employed the employee for a certain number of weeks. Other states do not charge an employer unless a specified amount of wages was paid.

7.1.2 Charging base-period employers in inverse chronological order

Some states charge base-period employers but limit the amount for each employer. The charge first is applied to the most-recent employer, then in inverse chronological order to previous employers. This method is based on the assumption that responsibility lessens for unemployment as time goes by.

A limit is placed on the amount any one employer may be charged. When the limit is reached, the next-previous employer is charged with the remainder. The limit is determined as either a fraction of the wages paid by the employer or as a specified amount in the base period or quarter, or both.

If the last employer in a base period employed a claimant for a considerable part of the base period or the claimant's unemployment is short, this method of charging base-period employers in inverse chronological order has the same effect as charging the most recent employer. If the claimant's unemployment is long, this method results in charging all base- period employers proportionately.

7.1.3 Charging proportionate base-period wages

Most states charge benefits to all base-period employers based on the wages earned from each employer by the claimant. This method is based on the assumption that unemployment is a result of the general conditions of the labor market rather than separation from a given employer.

7.2 Seasonal Workers

Several states have specific guidelines for identifying the employers of seasonal workers and charging them with benefits paid to these seasonal employees. Seasonal employers are generally charged only for benefits paid for unemployment during the seasonal period. Nonseasonal employers are charged for benefits for all periods.

7.3 Noncharging of Benefits

Depending on the particular state, some benefits are not charged to employers

— If the duration of unemployment is very short.

— If benefits are paid on the basis of a determination in a case that is appealed and later reversed.

— If benefits are paid following a period of disqualification for voluntary quitting, misconduct, or refusal of suitable employment.

— If the employer who employs a claimant part time in the base period continues to provide that claimant with equal part-time employment.

— If the benefits are being paid to a claimant who is taking approved training.

7.4 Voluntary Contributions

About half of the states allow employers to make voluntary contributions (these states all use the reserve-ratio formula). The voluntary contribution increases the balance in the employer's reserve so the employer is assigned a lower rate. An employer who will be increasing the number of employees in the coming year, for example, may benefit from making a voluntary contribution. This may result in a lower experience rating being applied to the larger wage base.

State agencies usually do not supply employers the amount of the voluntary contribution necessary to lower the experience rating, but worksheets are available to compute it. It is important to make the payment large enough to result in a lower rate since the voluntary contribution is often not refunded if it does not result in a reduced rate.

Voluntary contributions cannot be credited against the federal unemployment tax.

7.5 Successor Employers

Although laws vary from state to state, most states provide that the predecessor's experience rating be transferred to a successor employer. In order to receive this transfer of rating, certain conditions must be met, depending on the particular state:

— Successor assumes responsibility for contributions of predecessor.

— No substantial reduction of personnel takes place after the transfer.

— There is continuity of ownership or management.

— Successor continues same type of trade or business.

— Predecessor has ceased to do business.

If the successor employer was not subject to unemployment laws before the transfer, the successor will normally be required to use the predecessor's rate for the remainder of the year. If the successor was subject to unemployment laws prior to the transfer, the successor usually must continue to use that same rate for the remainder of the year, although some states recompute the successor's rate at the time of transfer.

When a business transfer occurs, both the predecessor and the successor should notify the appropriate state agencies. Most states provide special forms for this purpose and require filing within a limited time period.

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APPENDIX: State Unemployment Insurance Agencies

The following list contains addresses and telephone numbers of state unemployment insurance agencies as of August 1987:

ALABAMA
Department of Ind. Relations
Industrial Relations Bldg.
649 Monroe St.
Montgomery, AL 36130
(205)261-5386

ALASKA
Unemployment Insurance
Div. of Employment Security
Dept. of Labor
P.O. Box 3-7000
Juneau, AK 99802
(907)465-2712

ARIZONA
Dept. of Economic Security
1717 W. Jefferson
P.O. Box 6123-85005
Phoenix, AZ 85007
(602)255-5678

ARKANSAS
Employment Security Div.
Dept. of Labor
Capitol Mall, P.O. Box 2981
Little Rock, AR 72201
(501)371-2121

CALIFORNIA
Employment Development Dept.
800 Capitol Mall, Rm. 5000
Sacramento, CA 95814
(916)445-8008

COLORADO
Div. of Employment & Training
Dept. of Labor & Employment
251 E. 12th Ave.
Denver, CO 80203
(303)866-6561

CONNECTICUT
Unemployment Insurance
Dept. of Labor
200 Folly Brook Blvd.
Wethersfield, CT 06109
(203)566-4288

DELAWARE
Unemployment Insurance Div.
Dept. of Labor
University Plaza
P.O. Box 9029
Newark, DE 19714-9029
(302)368-6730

FLORIDA
Bur. of Unemployment
Compensation
Dept. of Labor & Employment
Security
201 Caldwell Bldg.
Tallahassee, FL 32399-0206
(904)488-6093

GEORGIA
Unemployment Insurance Div.
Dept. of Labor
254 Washington St. SW
Atlanta, GA 30334
(404)656-3050

HAWAII
Unemployment Insurance Div.
Labor and Industrial Relations
Dept.
830 Punchbowl St.
Honolulu, HI 96813
(808)548-6951

IDAHO
Dept. of Employment
317 Main St.
Boise, ID 83735
(208)334-6100

ILLINOIS
Dept. of Employment Security
910 S. Michigan
Chicago, IL 60605
(312)793-5700

INDIANA
Dept. of Employment Training Services
10 N. Senate Ave., Rm. 331
Indianapolis, IN 46204
(317)232-7670

IOWA
Bureau of Job Insurance
Dept. of Employment Services
1000 E. Grand Ave.
Des Moines, IA 50319
(515)281-5526

KANSAS
Division of Admin.
Dept. of Human Resources
401 SW Topeka Blvd.
Topeka, KS 66603
(913)296-5075

KENTUCKY
Div. of Unemployment Insurance
Cabinet for Human Resources
275 E. Main St.
Frankfort, KY 40621
(502)564-2900

LOUISIANA
Off. of Employment Security
Dept. of Labor
P.O. Box 94094
Baton Rouge, LA 70804-9094
(504)342-3113

MAINE
Bur. of Employment Security
Dept. of Labor
State House Station 54
Augusta, ME 04333
(207)289-2411

MARYLAND
Unemployment Insurance Admin.
Dept. of Economic & Employment Dev.
1100 N. Eutaw St.
Rm 614
Baltimore, MD 21201
(301)333-5502

MASSACHUSETTS
Div. of Employment Security
Exec. Off. of Economic Affairs
Charles F. Hurley Bldg.
Government Center
Boston, MA 02114
(617)727-6600

MICHIGAN
Employment Security Comm.
Dept. of Labor
7310 Woodward Ave.
Detroit, MI 48202
(313)876-5500

MINNESOTA
Jobs Opportunities & Insurance
Dept. of Jobs & Training
390 N. Robert St.
St. Paul, MN 55101
(612)296-3567

MISSISSIPPI
Unemployment Insurance Div.
Employment Security Comm.
1520 W. Capitol St.
Jackson, MS 39203
(601)961-7700

MISSOURI
Div. of Employment Security
Labor & Industrial Relations
Dept.
421 E. Dunklin, Box 59
Jefferson City, MO 65104
(314)751-3215

MONTANA
Unemployment Insurance Div.
Dept. of Labor & Industry
Box 1728
Helena, MT 59624-1728
(406)444-2723

NEBRASKA
Unemployment Insurance
Dept. of Labor
P.O. Box 94600
Lincoln, NE 68509-4600
(402)475-8451

NEVADA
Employment Security Dept.
500 E. Third St.
Carson City, NV 89713
(702)885-4635

NEW HAMPSHIRE
Dept. of Employment Security
32 S. Main St.
Concord, NH 03301
(603)224-3311

NEW JERSEY
Unemployment & Disabilities
Insurance Services Div.
Dept. of Labor
John Fitch Plaza, Rm. 601
Trenton, NJ 08625
(609)292-2460

NEW MEXICO
Unemployment Insurance Bur.
Dept. of Labor
P.O. Box 1928
Albuquerque, NM 87103
(505)841-8431

NEW YORK
Dept. of Labor
Governor W. Averell
Harriman State Office
Building Campus
Albany, NY 12240
(518)457-2741

NORTH CAROLINA
Employment Security Comm.
Dept. of Commerce
700 Wade Ave.
P.O. Box 27227
Raleigh, NC 27611
(919)733-3941

NORTH DAKOTA
Job Insurance Div.
Job Service
1000 E. Divide Ave.
Bismarck, ND 58502
(701)224-2833

OHIO
Bur. of Employment Services
145 S. Front St.
Columbus, OH 43215
(614)466-2100

OKLAHOMA
Unemployment Insurance Div.
Employment Security Comm.
200 Will Rogers Bldg.
Oklahoma City, OK 73105
(405)557-7131

OREGON
Employment Div.
Dept. of Human Resources
875 Union St., NE
Salem, OR 97311
(503)378-3211

PENNSYLVANIA
Off. of Employment Security
Dept. of Labor & Industry
1720 Labor & Industry Bldg.
Harrisburg, PA 17120
(717)787-6223

RHODE ISLAND
Benefits Division
Dept. of Employment Security
24 Mason St.
Providence, RI 02903
(401)277-3612

SOUTH CAROLINA
Employment Security Comm.
1550 Gadsden St.
P.O. Box 995
Columbia, SC 29202
(803)758-2686

SOUTH DAKOTA
Div. of Unemployment Insurance
Dept. of Labor
420 S. Roosevelt
P.O. Box 4730
Aberdeen, SD 57401
(605)622-2302

TENNESSEE
Dept. of Employment Security
536 Cordell Hull Bldg.
Nashville, TN 37219
(615)741-2131

TEXAS
Employment Comm.
101 E. 15th St.
Austin, TX 78778-0001
(512)463-2652

UTAH
Job Service
Dept. of Employment Security
174 Social Hall Ave.
Salt Lake City, UT 84147
(801)533-2400

VERMONT
Unemployment Compensation Div.
Dept. of Employment & Training
Green Mountain Dr.
Montpelier, VT 05602
(802)229-0311

VIRGINIA
Employment Comm.
703 E. Main St.
Richmond, VA 23219
(804)786-3001

WASHINGTON
Dept. of Employment Security
212 Maple Park
Olympia, WA 98504-5311
(206)753-5114

WEST VIRGINIA
Dept. of Employment Security
112 California Ave., Rm. 608
Charleston, WV 25305
(304)348-2630

WISCONSIN
Unemployment Compensation Div.
Dept. of Industry, Labor & Human Relations
P.O. Box 7903
Madison, WI 53707
(608)266-7074

WYOMING
Unemployment Compensation Div.
Employment Security Comm.
P.O. Box 2760
Casper, WY 82602
(307)235-3254

DISTRICT OF COLUMBIA
Off. of Unemployment Compensation
Dept. of Employment Services
50 C St., NW, Rm. 515
Washington, DC 20001
(202)639-1163

GUAM
Dept. of Labor
P.O. Box 23548
GMF, GU 96921
(671)646-9241

PUERTO RICO
Bur. of Employment Security
Labor & Human Resources Dept.
50 Munoz Rivera Ave.
Hato Rey, PR 00918
(809)754-5375

VIRGIN ISLANDS
Employment Security Agcy.
Dept. of Labor
P.O. Box 1092
St. Thomas, VI 00801
(809)776-3700

EMPLOYEE RETIREMENT AND DEFERRED COMPENSATION PLANS

EMPLOYEE RETIREMENT AND DEFERRED COMPENSATION PLANS

1. OVERVIEW OF RETIREMENT PLANNING

This section introduces retirement and deferred compensation planning, particularly for small business employers. Statutory requirements for tax qualification are described. Because of their popularity and suitability for small business employers, defined contribution plans are described in more detail, particularly profit-sharing, money purchase, IRC Section 401(k) cash or deferred arrangements, and employee stock ownership plans.

1.1 Why Have a Formal Plan?

The following reasons are often cited as inducements for employers to adopt formal retirement and deferred compensation plans for their employees:

— Competition for top-notch talent forces adoption of a comprehensive plan.

— Payroll costs can be lowered by reducing employee turnover.

— Older, sometimes less productive, employees can be encouraged to move into retirement.

— Employee and public relations are enhanced when workers are aided in their retirement planning.

While good business reasons dictate establishment of a formal plan, tax reasons motivate adoption of tax-qualified plans. Qualified plans lower an employer's after-tax cost of providing benefits.

1.2 Qualified Versus Nonqualified Plans

Tax advantages are available if the formal plan meets the complex qualification rules of IRC Section 401(a):

— Plan participants defer tax until they receive distributions.

— Favorable tax treatment may be accorded the distributions.

— Employers currently deduct their contributions to the plan.

— Compounding of earnings on plan assets proceeds at a greater rate since earnings are not currently taxed.

In contrast, nonqualified plans provide limited tax benefits but are less expensive to adopt and sponsor. Nonqualified plans tend to be more popular because of tax law changes effected by the Tax Reform Act of 1986. Nonqualified plans are described in section 11 of this chapter.

2. CHOOSING A PLAN: TYPES OF QUALIFIED PLANS

This chapter concentrates on qualified plans because of their widespread popularity. Qualified plans are classified as either *defined contribution* or *defined benefit* plans.

2.1 Defined Contribution Plans

A *defined contribution plan* is a plan that provides for benefits based on the amounts contributed by the employer or employee, increased by income, gains, and other participants' forfeitures. Decreases come about with investment losses and plan expenses (IRC Section 414(i)). Such plans provide each participant with individual accounts to which are allocated increases and decreases. The resulting account balance represents the individual's retirement benefit. Following are common types of defined contribution plans:

— Profit sharing

— Stock bonus

— Money purchase pension

— Thrift or savings

— Target benefit

— Cash or deferred arrangement

— Employee stock ownership

Listed here are characteristics of defined contribution plans:

— An account is set up for each participant.

— Contributions are allocated to each participant's account.

— Benefits are based on the balance in a participant's account when the participant retires or otherwise receives distribution of the account.

— The balance in a participant's account depends upon gains, losses, and income on the plan's assets, plus contributions, administrative expenses, and the forfeiture by other participants of their accounts.

— In some plans, a degree of discretion is allowed the employer when determining annual contributions.

Retirement benefits are available only to the extent that the custodian of the plan assets makes successful investment of contributions to the plan. These plans are generally more beneficial to younger employees who have time before retirement to wait for the accumulation of contributions and earnings, and to employees who are willing to accept the risk and reward of plan investments.

2.2 Defined Benefit Plans

A *defined benefit plan* is any plan that is not a defined contribution plan (IRC Section 414(j)). In a defined benefit plan

— Definite levels of benefits are promised.

— Distributions are available in the form of annuities for life payable upon retirement (or, in the case of married participants, for joint and survivor's life).

— Contributions required of the employer are calculated actuarially without regard for the level of profitability of the employer's business.

A defined benefit plan, or *pension,* is the traditional medium for retirement planning. With a pension plan, the level of retirement benefits is expressly promised; uncertainty is removed because retirement benefits are known. Since these benefits must be paid for by the employer, the risks and burdens fall on the employer. The Pension Benefit Guaranty corporation provides insurance as backstop for failed employers, but this protection is paid for by the employer in the form of premiums. Older employees ordinarily prefer a pension plan for its predetermined benefits and the opportunity it may provide for credits for service performed prior to the adoption of the plan. These are called *past service credits.* Adoption of a pension plan for older employees can result in very large tax deductions. By adopting such a plan, however, the employer is committed to fund the benefits in a short time period.

3. STATUTORY REQUIREMENTS FOR QUALIFIED PLANS

3.1 Qualification Requirements

To be "qualified," the plan and trust must satisfy both in form and operation the following requirements:*

— The plan must be funded through a trust or equivalent entity created or organized in the United States (Sec. 401(a)).

*Unless otherwise noted, all references are to the Internal Revenue Code.

— The plan must be a stock bonus, pension, or profit-sharing plan established by an employer for the exclusive benefit of its employees or their beneficiaries (Sec. 401(a)).

— Contributions must be made for the purpose of distributing the accumulated corpus and income to employees or their beneficiaries (Sec. 401(a)(1)).

— Plan assets must not be used for, or diverted to, purposes other than the exclusive benefit of employees and their beneficiaries prior to the satisfaction of all liabilities with respect to employees and their beneficiaries (Sec. 401(a)(2)).

— The plan must satisfy certain minimum participation requirements (Secs. 401(a)(3) and 410).

— Contributions or benefits must not discriminate in favor of officers, shareholders, or highly compensated employees (Secs. 401(a)(4) and (5)).

— The plan must satisfy certain minimum vesting requirements (Secs. 401(a)(7) and 411).

— If the plan is a defined benefit pension plan, forfeiture cannot be used to increase the benefits and must instead be used to reduce future employer contributions or administrative expenses (Sec. 401(a)(8)).

— The plan must satisfy certain distribution timing requirements (Sec. 401(a)(9)).

— If the plan is or might become "top-heavy," it must satisfy the requirements of IRC Section 416 (Sec. 401(a)(10)).

— The plan must provide that benefits are payable in the form of a joint and survivor annuity for the participant and spouse. Or, in the case of a defined contribution plan, all amounts in the account must be paid to the surviving spouse. In the case of a vested participant who dies before retirement, a survivor annuity, or the account, must be payable to a surviving spouse (Secs. 401(a)(11) and 417). The participant can choose another beneficiary with the written consent of the spouse.

— In the case of a merger, consolidation with, or transfer of assets or liabilities to another plan, each participant must be entitled to receive immediately after the merger, consolidation, or transfer no less than would have been received immediately before the merger, consolidation, or transfer if the plan had then terminated (Sec. 401(a)(12)).

— Benefits cannot be assigned or alienated, with certain minor exceptions. For example, benefits payable pursuant to a qualified domestic relations order are permissible assignments (Secs. 401(a)(13) and 441(p)).

— Benefits must commence, unless the participant elects otherwise, not later than sixty days after the end of the plan year in which occurs the latest of

The earlier of age sixty-five or the normal retirement age under the plan.

The tenth anniversary of the date the employee became a participant.

The date the participant terminates employment (Sec. 401(a)(14)).

— If the plan provides an early retirement benefit, a participant who satisfies the service requirement prior to terminating employment must be entitled to receive an actuarially reduced normal retirement benefit upon reaching the age for early retirement (Sec. 411(d)(6) and Treas. Regs. Sec. 1.411(a)(7)).

— Benefits must not be reduced because of changes in Social Security benefits or the Social Security wage base after a participant starts receiving benefits or is separated from service.

— The plan may not provide benefits or contributions that exceed the limitations of IRC Section 415 (Sec. 401(a)(16)).

— The plan may not provide for forfeitures of benefits in the event of certain withdrawals of an employee's own contributions (Secs. 401(a)(19) and 411).

— A defined benefit pension plan must specify the actuarial assumptions in a way that precludes employer discretion (Sec. 401(a)(25)).

— The plan must be in writing and be communicated to employees. (Treas. Regs. Sec. 1.401-1(a)(2)).

— The plan must be intended as a permanent program (Treas. Regs. Sec. 1.301-1(b)(2)).

— The plan and trust must be adopted in writing prior to year end (Treas. Regs. Sec. 1.401-1(a)(2)).

— The plan cannot force an employee to take a lump-sum distribution before retirement age unless the value of the benefit is $3,500 or less (Sec. 411(a)(11)).

— Death benefits payable to the beneficiary of an employee must be incidental to the primary purpose of distributing accumulated funds to the employee.

3.2 Eligibility to Participate

Although a plan permits any employee to participate on the date of hire, most plans restrict an employee's eligibility to participate. Restrictions are permissible only under the guidelines of IRC Section 401(a) and fall into two general categories.

3.2.1 Age and service requirements (IRC Sec. 410(a))

— An employee under age twenty-one can be excluded.

— An employee who has completed less than one year of service can be excluded. If the plan provides full vesting after completing three years of service, an employee who has completed less than three years of service can be excluded. For plan years beginning after December 31, 1988, participation cannot be conditioned on more than two years of service and can require two years of service only if benefits are vested immediately.

For plan years beginning on or after January 1, 1988, an employee who has attained a specified age and has at least one hour of service after calendar year 1987 cannot be excluded from participation on the basis of age. (Prior to 1988, an employee hired within five years of the plan's normal retirement age can be excluded from a defined benefit pension or target plan (IRC Sec. 410(a)(2)).

As a general rule, all service beginning with the employee's date of hire is included in determining whether the employee has satisfied the minimum service requirements. If the plan so provides, the following years may be excluded:

— Any twelve-month period commencing with the date of hire in which an employee works less than 1,000 hours.

— Certain years prior to a break in service in the case of employees rehired after the break.

3.2.2 Work force requirements

Restrictions other than age and service may be permissible ways to exclude some employees. Common restrictions include

— Job classification.

— Pay categories.

— Required contributions.

— Location of employment.

For example, an employer may choose to cover only salaried employees, only employees employed at specified plant locations, or only workers not covered by a collective bargaining agreement. These, and other classifications, can be acceptable if they have a business purpose and do not operate so as to discriminate in favor of officers, shareholders, or highly compensated employees (IRC Secs. 410(b)(1)(B) and 410(b)(3)).

3.2.3 Entry dates

An employee who has satisfied the participation requirements must become a participant not later than six months after satisfying the requirements, but in no event later than the first day of the next plan year (IRC Sec. 410(a)(4)). Although entry can be deferred for as long as six months after satisfying the participation requirements, participation can be permitted on the date of hire. Any date between the date of hire and the last day permitted by law is acceptable.

3.2.4 Minimum participation

For plan years beginning after December 31, 1988, each plan must cover the lesser of fifty employees or 40 percent of all employees (IRC Sec. 401(a)(26)). This requirement cannot be met by considering two plans as one. However, if certain employees are excluded from participation, they can then be excluded from the percentage test. These employees are union members and those who do not meet the plan's minimum age and years-of-service requirements (IRC Secs. 410(b)(3)(A) and 410(b)(4)(A)). If employees who do not meet the minimum age and years-of-service requirements are covered under yet another plan that does satisfy these minimum participation prerequisites, those employees can also be excluded from the test under the following three conditions (IRC Sec. 401(a)(26)(B)(ii)):

1. The benefits for such employees are provided under the same plan as benefits for other employees.
2. The benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan.
3. No highly compensated employee is included in the group of such employees for more than one year.

Plans not complying with the minimum requirements must be merged or terminated by the end of the first plan year to which the rule applies. Multi-employer plans are exempt from this minimum participation requirement, except for plans established by unions for professionals, such as physicians or lawyers.

3.2.5 Minimum coverage

Until plan years beginning on or after January 1, 1989, three alternative tests are provided to assess whether restrictions on coverage discriminate in favor of officers, shareholders, or highly compensated employees:

1. The plan must benefit at least 70 percent of all employees.
2. The plan must benefit at least 80 percent of eligible employees, provided that at least 70 percent of employees are eligible to participate.
3. The plan's participation requirements are determined not to discriminate in favor of officers, shareholders, or highly compensated employees.

Employees who have not satisfied the minimum age and service requirements can be excluded from both percentage tests (IRC Sec. 410(b)(1)(A)). Employees covered by collective bargaining agreements (if retirement benefits were the subject of good-faith bargaining) and nonresident aliens who receive no earned income from U.S. sources can be excluded from all three tests (IRC Sec. 410(b)(3)).

The nondiscriminatory classification test must take into account all the facts and circumstances. For purposes of this test, employees who do not satisfy the minimum age or service requirements must be taken into account. Generally, under this test, the plan must be shown to cover a fair cross section of all employees required to be taken into account. Revenue Ruling 83-58, IRB 83-14,7 presents the view of the IRS concerning the fair-cross-section test. Under the test, the percentage of highly compensated employees covered by the plan cannot be significantly larger than the percentage of non-highly-compensated employees covered by the plan. For example, a plan covering all highly compensated employees and only half the non-highly-compensated employees would not be considered to cover a fair cross section of employees.

If a plan cannot meet the fair-cross-section test or the percentage test when considered independently of other plans, the employer can aggregate comparable plans to meet one of the tests (Treas. Regs. Sec. 1.410(b)-1(d)(3)). In some cases, defined contribution and defined benefit plans can be determined to provide comparable benefits and thus can be combined for the test (Rev. Rul. 81-202, IRB 1981-34,5).

For plan years beginning after December 31, 1986, an employee is highly compensated if, at any time during the current or preceding year, he or she

— Was a more-than-5-percent owner (determined after applying attribution rules);

— Earned more than $75,000 from the employer;

— Earned more than $50,000 and also was in the top 20 percent of all employees ranked on the basis of compensation paid during the year; or

— Was an officer who received compensation exceeding $45,000, an amount which is 150 percent of the defined contribution plan limit as provided in IRC Section 415(c) (IRC Sec. 414(q)).

To provide stability to this highly compensated group, an individual other than a more-than-5-percent owner will not be included in the group unless he or she either

— Was included in the group for the preceding year, or

— Is one of the 100 highest paid employees of the employer.

Although the single highest paid officer will always be considered highly compensated, no more than fifty employees will be considered officers (or, if fewer, the greater of three employees or 10 percent of the employees) (IRC Sec. 414(q)(5)).

If an employee is a family member either of a 5-percent owner or of an individual who is one of the ten most highly compensated employees of the employer, the compensation paid to that individual is treated as if paid to the 5-percent owner or highly compensated employee. Family members include spouses and lineal ascendants and descendants, but not brothers or sisters (IRC Sec. 414(q)(6)).

A former employee is treated as highly compensated if he or she was highly compensated at the time of separation of service, or at any time after reaching age fifty-five (IRC Sec. 414(q)(9)).

For plan years beginning after December 31, 1988, the three coverage tests are revised. In general, the plan must benefit at least

— 70 percent of all non-highly-compensated employees;

— A percentage of non-highly-compensated employees that is at least 70 percent of the percentage of highly compensated employees benefited; or

— A fair cross section of employees.

The fair-cross-section test can be used only if an average benefit percentage test is also met. This average benefit percentage test is met if the average benefit percentage for non-highly-compensated employees is at least 70 percent of the average benefit percentage for those who are highly compensated. The benefit percentage is calculated as the employer-provided contribution or benefit expressed as a percentage of the employee's compensation. A benefit percentage is determined for each employee, and the average benefit is then calculated.

In general, the new coverage rules increase required coverage of non-highly-compensated employees and allow fewer numbers of non-highly-compensated employees to be covered only if the benefits they receive as a group are not materially less than the benefit provided to highly compensated employees as a group.

3.3 Discriminatory Contributions or Benefits

A plan cannot provide benefits or contributions that are discriminatory (IRC Sec. 401(a)(4)). For defined contribution plans, the test is met if contributions as a percentage of compensation are not discriminatory (Treas. Regs. Sec. 1.401-4(a)(2)). For defined benefit plans, the test is applied to benefits accrued and available at retirement. Within certain guidelines, employer payments of Social Security taxes may be considered in determining if contributions are discriminatory (IRC Sec. 401(1)). Also under guidelines specified in the Internal Revenue Code, Social Security benefits may offset benefits provided under a defined benefit pension plan and be considered in determining whether a plan's benefits are discriminatory (IRC Sec. 401(a)(5)).

3.3.1 Employer contributions to defined contribution plans

Each defined contribution plan must contain a formula for allocating employer contributions (Treas. Regs. Sec. 1.401-1(b)(1)(ii)). Most formulas allocate contributions on the ratio of the participant's compensation to total compensation of all participants. A plan may require that a participant must complete 1,000 or more hours of service during the plan year in order to share in the allocation. It is also permissible to provide that an employee who is not employed at year end does not share in the allocation.

3.3.2 Employee or matching contributions

IRC Section 401(m), effective for plan years beginning after December 31, 1986, provides a nondiscrimination test for matching contributions and employee contributions. A plan meets this test—the contribution percentage requirement test—if the contribution percentage for eligible highly compensated employees does not exceed the greater of

- 125 percent of such percentage for all other eligible employees, or
- The lesser of 200 percent of such percentage for all other eligible employees, or such percentage for all other eligible employees plus two percentage points.

The contribution percentage for a specified group of employees is the average of the ratios for each employee. (To convert a ratio to a percentage, multiply the ratio by 100.) The ratio is calculated by dividing the sum of the employee and matching contributions by the employee's compensation.

3.3.3 Defined benefit accruals

Participants accrue benefits in a defined benefit plan in accordance with the benefit formula in the plan and one of the following benefit accrual standards (IRC Sec. 411(b)(1)):

— *3-percent method.* Each participant's accrued benefit upon termination of employment must be at least 3 percent of the normal retirement benefit that the employee would receive if participation commenced at the earliest age and continued until age sixty-five or the normal retirement age in the plan, if earlier, multiplied by the employee's years of participation (maximum 33 1/3).

— *133 1/3 percent rule.* The accrual rate for any year must not exceed 133 1/3 percent of the accrual rate for any prior year.

— *Fractional rule.* Each participant's accrued benefit upon termination must be at least equal to a fraction of the participant's actual years of participation to potential years of participation if he or she serves until normal retirement age, multiplied by the normal retirement benefit.

In calculating the benefit accruals for these tests, years of participation may be used. Accordingly, years of service prior to entry into the plan as a participant can be ignored. A year of service is a 1,000-hour period. Years in which less than 1,000 hours are completed can be ignored. Unlike a defined contribution plan, a defined benefit plan must provide accrued benefits if a participant works 1,000 hours during the year, even if not employed at year end.

3.4 Integration With Social Security

Employers provide retirement benefits for employees by contributing to Social Security. Because retirement benefits under Social Security are limited by the taxable wage base, more highly compensated employees receive a smaller percentage of their retirement compensation from Social Security than do employees whose compensation does not exceed the wage base. Any cost-conscious employer should consider integrating his retirement plan with Social Security.

The theory of integrating a private retirement plan with the public Social Security retirement plan is that an employer may, through integration, provide equal retirement benefits, expressed as a percentage of compensation, for all employees. Thus, integration of a plan can result in greater benefits from the employer's plan for more highly compensated employees, though this result can be achieved without creating the prohibited types of discrimination. The Social Security benefits expected by older employees are often less than the benefits paid to younger employees. As a result, owners, who tend to be among the older members of the company's work force, receive fewer benefits from Social Security than their younger employees, though they do receive more benefits from a private plan.

3.4.1 Integration of defined contribution plans

Integration of Social Security with a defined contribution plan is relatively easy to incorporate into a plan. For plan years beginning after December 31, 1988, contributions in excess of the plan's integration level cannot be greater than twice the contribution provided below that level, subject to a cap equal to 5.7 percent of compensation. The integration level is the compensation amount specified under the plan, whether by dollar value or formula, at or below the rate (expressed as a percentage) set for the contributions (or benefits) provided, but less than the rate above that compensation amount (IRC Sec. 401(1)(5)). The integration level can be any amount up to the Social Security tax wage base in effect at the beginning of the plan year ($45,000 for 1988). According to IRC Section 401(1)(2)(A), the excess contribution percentage may not exceed the base percentage by more than the lesser of

- — The base contribution percentage, or
- — The greater of 5.7 percentage points, or the rate of tax in effect under IRC Section 3111(a).

Since the current rate of tax is 5.7 percent, the excess contribution percentage is capped at 5.7 percent.

> *Example 1.* If the contribution percentage for compensation below the integration level is 3 percent, the contribution percentage for compensation above the integration level can be no more than 6 percent.
>
> *Example 2.* If the IRC Section 3111(a) rate is 5.7 percent, as it is currently, and the contribution percentage for compensation up to the integration level is 8 percent, the excess contribution percentage can be no more than 13.7 percent.

An ESOP established after October 31, 1977, must not be integrated with Social Security.

3.4.2 Integration of defined benefit plans

Two basic approaches to integration of defined benefit pension plans have been developed: (1) the offset approach, and (2) the excess approach. A plan that integrates under the offset approach is referred to as an offset plan. An offset plan provides each employee with an annual pension benefit, which is expressed as the difference between a gross benefit and a portion of that employee's Social Security benefit that is deemed to be the employer-provided Social Security benefit. In 1971, the IRS determined that the value of employer-provided Social Security benefits is equal to 83 1/3 percent of the annualized primary insurance amount to which an employee is entitled under Social Security. Consequently, an offset plan can integrate with Social Security by providing each employee retiring under the plan an annual benefit of, for example, 50 percent of pay offset by 83 1/3 percent of the employee's primary insurance amount.

The theory underlying the excess approach is that the Social Security system provides benefits based on only a certain portion of an employee's earnings. An excess plan is designed to provide benefits, based on the portion of an employee's earnings, in excess of the integration level—the earnings on which Social Security benefits are provided. An excess plan properly integrates if the benefits, with respect to compensation in excess of the integration level, are not greater, as a percentage of pay, than the benefits provided by Social Security on compensation up to the integration level. The IRS determined that the employer-provided portion of benefits under Social Security averages 37 1/2 percent of the average annual maximum wages on which Social Security benefits are based. Consequently, for an employee retiring at age sixty-five with at least fifteen years of service in 1986, an excess plan will integrate properly if it provides benefits at a rate no greater than 37 1/2 percent of final average compensation in excess of approximately $15,000; however, the excess plan does not provide benefits with respect to the first $15,000 of final pay.

For plan years beginning after December 31, 1988, rather than require a parity with Social Security, the integration rules allow a "permitted disparity in plan contributions or benefits." In an excess plan, the excess benefits percentage—benefits provided, with respect to compensation in excess of the integration level, that are expressed as a percentage—may not exceed the base benefit percentage by more than the maximum excess allowance. The maximum excess allowance, with respect to benefits attributable to a year of service, is the lesser of the base benefit percentage, or three-quarters of a percentage point. With respect to total benefits, the maximum excess allowance is the lesser of the base benefit percentage, or three-quarters of a percentage point times the participant's years of service taken into account under the plan (but not exceeding thirty-five years).

For plan years beginning after December 31, 1988, the maximum offset allowance in offset plans for any year of service is the lesser of 50 percent of the benefit that would have accrued without regard to the offset reduction, or three-quarters percent of the participant's final average compensation, times the participant's years of service (not in excess of thirty-five). Regulations will be written for rules to reduce the three-quarters factor for participants with final average compensation in excess of covered compensation and, also, for participants in plans providing for unreduced retirement benefits to be paid at early retirement.

3.5 Vesting

Although an employer has contributed to a plan, an employee can be prevented from receiving benefits from that plan unless the employee remains employed for a specified time. When benefits or contributions cannot be forfeited by the employee, that employee is then said to be vested. All plans must satisfy four basic vesting rules:

1. An employee must be vested at the normal retirement age (IRC Sec. 411(a)).
2. An employee must always be vested in his or her own contributions (IRC Sec. 411(a)(1)).
3. To the extent that benefits have been funded, employees must be vested if the plan terminates, or on complete discontinuance of contributions to a profit-sharing or stock bonus plan (IRC 411(d)(3)).
4. An employee must be vested as to the employer's contributions after completing service required under one of three statutorily permissible vesting schedules (IRC. Sec. 411(a)(2)).

For plan years beginning prior to 1989, the plan must specify how contributions will vest, and employer contributions must vest at least as rapidly as they would under one of the following three schedules:

— *Cliff vesting.* Employees have no vesting until ten years of service.

— *Graduated, or five- to fifteen-year vesting.* Employees having five or more years of service are vested in a percentage of benefits at least equal to the following table. No vesting occurs prior to completion of five years of service.

Years of Service	Vested Percentage
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100

— *Rule-of-45 vesting.* Employees having five or more years of service and whose age plus years of service equals or exceeds forty-five are vested according to the following table. Any employee having at least ten years of service must be at least 50 percent vested and must receive an additional ten percent vesting credit for each additional year.

If years of service equal or exceed	and sum of age and years of service equals or exceeds	then the vested percentage is
5	45	50
6	47	60
7	49	70
8	51	80
9	53	90
10	55	100

Small business employers should be careful that the vesting schedule does not favor officers, shareholders, or highly compensated employees. To reduce the suggestion of discrimination in vesting, the following so-called 4-40 percent vesting schedule has been considered acceptable. The 4-40 schedule does not protect the plan, however, if there exists a pattern of firing employees to avoid vesting.

Years of Service	Vested Percentage
Less than 4	0
4	40
5	45
6	50
7	60
8	70
9	80
10	90
11 or more	100

As a general rule, all service beginning with the employee's date of hire is included in determining the vested percentage. If the plan so provides, the following years may be excluded:

— Any twelve-month period provided in the plan in which the participant works fewer than 1,000 hours

— Years prior to age eighteen, except in the case of a plan using the rule-of-45 vesting schedule

— Years when the employee does not make a required contribution to the plan

— Years prior to adoption of the plan or a predecessor plan

— Certain years prior to a break in service in the case of employees rehired after the break

For plan years beginning after December 31, 1988, benefits provided by employer contributions must vest at least as rapidly as one of the two alternative vesting schedules—cliff vesting or graduated vesting. Cliff vesting requires full vesting upon completion of five years of service, whereas graduated vesting specifies the following percentages:

Years of Service	Vested Percentage
3	20
4	40
5	60
6	80
7	100

Multi-employer plans must provide 100 percent vesting after ten years of service. Plans requiring two years of service for participation must provide 100 percent vesting after the two years.

In most cases, an employee having at least one hour of service after 1988 will be subject to the new vesting schedules. For example, an employee who has been credited with seven years of service by the close of December 31, 1988, and who participates in a plan that has ten-year cliff vesting, will be fully vested when he or she is credited with one more hour of service.

3.6 Funding Obligations

Defined benefit and money purchase pension plans are subject to certain funding obligations. Funding obligations are not imposed on profit-sharing and stock bonus plans. If an employer fails to satisfy the pension funding obligations and does not receive a waiver or extension, a nondeductible 5-percent penalty tax is imposed for each year the deficiency continues. For a money purchase pension plan, the required contribution each year is generally equal to the amount determined under the contribution formula for the year.

Subject to certain limitations, an employer may make deductible contributions to a qualified defined benefit plan up to the plan's full funding limitation. Under the new rules established by the Omnibus

Budget Reconciliation Act of 1987, the full funding limitation is the excess, if any, over the plan's assets of the lesser of 150 percent of current liability or the accrued liability (including normal cost) under the plan. If the plan's liabilities cannot be directly determined under its funding method, they can be determined under the entry age normal funding method. The value of the plan's assets is the lesser of the assets' fair market value, or the assets' value determined under the rules in IRC Section 412(c)(2). Current liability is defined under IRC Section 412(l)(7) to mean all liabilities to employees and their beneficiaries under the plan as determined under IRC Section 401(a)(2) as if the plan had terminated. The secretary of the Treasury is empowered to prescribe full funding limitations based on factors other than current liability.

In the operation of a defined benefit pension plan, a funding standard account is established, and certain charges and credits are made to determine whether there is an accumulated funding deficiency (IRC Sec. 412(b)(1)). The funding standard account in the case of single-employer plans is charged with

— The normal cost for the plan year.

— The amount necessary to amortize in equal annual installments

  The unfunded past service liability over thirty years (forty in the case of plans in existence on January 1, 1976);

  Any increase in unfunded past service liability arising from plan amendments over thirty years;

  Any net experience loss (that is, adverse actual experience in relation to the actuarial assumptions) over fifteen years;

  Any net loss arising from changes in the actuarial assumptions over thirty years.

— The amount necessary to amortize any waived funding deficiency over fifteen years.

The funding standard account is credited with

— The contributions, including forfeitures, for the year.

— The amount necessary to amortize in equal annual installments

  The net decrease in unfunded past service liability arising from plan amendments over thirty years;

  The net experience gain over fifteen years;

  The net gain resulting from changes in actuarial assumptions over thirty years.

— The amount of any waived funding deficiency for the year.

The Omnibus Budget Reconciliation Act of 1987 modified the IRC Section 412 minimum funding requirements by increasing the amount that is charged to the funding standard account of any plan that is underfunded. The increase is not to exceed the amount necessary to increase the funded current liability to 100 percent. The increase is (1) the unpredictable contingent-event amount for the plan year plus (2) the excess of the deficit reduction contribution over the amount necessary to amortize (a) past service liability, (b) each waived funding deficiency, (c) certain amounts credited in the case of an employer's previously using the alternative minimum funding standard account, reduced by the amounts necessary to amortize decreases in past service liability. Unpredictable contingent events include, but are not limited to, facility shutdowns and reductions in workforce. The increase charged to the standard account is not to exceed the amount necessary to increase the funded current liability percentage to 100 percent. These funding rules do not apply to plans that had 100 or fewer participants on each day during the preceding plan year.

In some cases, the fair market value of plan assets exceeds the total accrued liabilities under the plan because of, for example, a substantial increase in the value of its investment portfolio. No contribution is due if the full funding limitation is reached, even if there would otherwise be an accumulated funding deficiency.

If the funding obligations are not satisfied within eight-and-one-half months after the plan year, a nondeductible 5-percent penalty tax is imposed for each plan year that the deficiency continues. The eight-and-one-half-month period is not dependent upon the filing of the employer's tax return or the rules governing the timing of contributions for deduction purposes. An employer that is liable for the 5-percent penalty tax is required to file IRS Form 5330 and pay the tax within seven months after the end of its plan year.

3.7 Limitations on Contributions and Benefits

Limitations are imposed on the amounts of benefits that can be provided from defined benefit plans as well as the amounts of contributions that can be made to defined contribution plans (IRC Sec. 415). Additional limitations are imposed on combinations of the plans.

3.7.1 Defined benefit plan limits

Effective January 1, 1988, a defined benefit plan may not provide a participant an annual benefit in excess of the lesser of $94,023 or 100 percent of the participant's average compensation for his or her high three consecutive years.

The primary limitation is based on a benefit payable annually in the form of an annuity for the life of the participant, beginning at the Social Security retirement age. If the benefit is in any other form, or if the employee is required to contribute, or if the benefit begins at an age other than the Social Security retirement age, certain adjustments to the limitation must be made. No adjustment, however, is required if the form of benefit is a qualified joint and survivor annuity. The $94,023 limit is reduced proportionately for less than ten years of plan participation.

Participants who have, prior to 1987, accrued higher benefits than allowed, will be permitted to receive them. Those participants cannot, however, continue to accrue additional benefits. For this reason, many older individuals participating in defined benefit plans before 1987 can no longer increase their retirement savings in this type of plan.

3.7.2 Defined contribution plan limits

Although the limit on defined benefit plans is based on the annual benefit provided to a participant, in a defined contribution plan the annual addition is limited. Annual additions allocated to a participant's account in a defined contribution plan cannot exceed the lesser of $30,000 or 25 percent of compensation. The term *annual addition* includes both employer and employee contributions, and forfeitures. The term does not include rollover contributions or the direct transfer of assets between plans (Treas. Regs. Sec. 1.415-6(b)(3) and IRC Sec. 415(c)).

3.7.3 Combined plan limits

If an individual participates in both a defined contribution plan and a defined benefit plan of the same employer, another limit is imposed

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An individual cannot receive a total retirement benefit in excess of the lesser of 125 percent of the separate plan dollar limits or 140 percent of the separate plan percentage limits (IRC Sec. 415(a)). An excise tax is imposed on the amounts payable under plans of unrelated employers if such amounts exceed $150,000 per year (IRC Sec. 4981A).

3.8 Top-Heavy Plans

For plan years beginning after 1983, a plan in which more than 60 percent of the present value of accrued benefits in a defined benefit plan, or more than 60 percent of account balances in a defined contribution plan, are attributable to key employees is top-heavy (IRC Sec. 416(g)). A key employee is an officer earning more than $45,000 or 150 percent of the limit contained in IRC Section 415(c)(1)(A), a more than 5-percent owner, or a more than one-percent owner whose annual compensation exceeds $150,000. Also classified as a key employee is each of the ten employees earning more than $30,000 (the current limit expressed in IRC Section 415(c)(1)(A)) and owning the largest interests in the employer IRC Section 416(i).

Top-heavy plans must satisfy three additional requirements:

1. Vesting is accelerated.
2. Minimum benefits or contributions must be provided.
3. Compensation taken into account under the plan is limited to $200,000.

A top-heavy plan must provide full vesting after completion of three years of service or graduated vesting in accordance with the schedule that follows. Years not required to be taken into account under the usual vesting rules (for example, service prior to age eighteen or before adoption of the plan) can be excluded (IRC Sec. 416(b)).

Years of Service	Vested Percentage
2	20
3	40
4	60
5	80
6 or more	100

A top-heavy defined benefit pension plan must provide a minimum benefit equal to 2 percent of the participant's average compensation for each of his or her high five years of service after 1983, which is subject to a maximum benefit of 20 percent. The benefit required is a single-life annuity commencing at the normal retirement age (IRC Sec. 416(c)(1)).

A top-heavy defined contribution plan must provide a minimum contribution for each participant equal to 3 percent of compensation unless the employer contribution for key employees is less (IRC Sec. 416(c)(2)). In determining whether these minimum benefits or contributions have been provided, salary reduction amounts, but not Social Security taxes, may be taken into account.

An employee covered by both a defined contribution and a defined benefit plan, either of which is top-heavy, must generally meet a lower combined limit test.

In general, if the defined benefit minimum is provided, these rules are satisfied. Alternatively, if a defined contribution plan provides for a minimum contribution of at least 5 percent of the annual compensation, the test is met (Treas. Regs. Sec. 1.416-1, m-13).

An individual who participates in a top-heavy plan cannot receive total retirement benefits from the employer and related employers in excess of 100 percent of the separate plan dollar limits or 140 percent of the separate plan percentage limits. An exception applies to top-heavy plans that are not *excessively* top-heavy. If 90 percent or less of a plan's benefits go to key employees, and additional minimum benefits or contributions are provided to non-key-employees, the usual combined plan limits apply. The additional minimum benefit required is a calculation of one percentage point multiplied by years of service times the average compensation, resulting in a total minimum contribution of years of service times 3 percent of average compensation, but up to a limit of 30 percent of compensation. The additional minimum contribution required is 1 percent of compensation, which results in a total required minimum contribution to a defined contribution plan of 4 percent of compensation.

3.9 Section 401(k) Cash or Deferred Arrangements (CODAs)

A CODA is a plan under which the participants may receive in cash a portion of the employer's contribution that would otherwise be paid into their accounts. Contributions subject to the participant's election are *elective contributions.* Contributions not subject to the election are *nonelective contributions.* These two types of contributions must be accounted for separately; neither type is included in the participant's gross income. Only the portion actually received in cash is considered taxable income. Constructive receipt of income, and thus its taxability, would normally result as a consequence of the existence of an election. IRC Section 402(a)(8) specifically precludes this result.

Effective January 1, 1988, individuals may defer up to $7,313 of their compensation annually, determined on a calendar-year basis (IRC Sec. 402(g)). Because a CODA allows an employee a choice between either receiving cash or a retirement benefit, certain additional qualification rules must be met. In addition to the qualification rules that apply to all plans,

— Amounts deferred from taxation by payment into the qualified trust may not be paid out, without penalty, to the employee prior to death or retirement, except in the case of disability, termination of employment, hardship, attainment of age fifty-nine-and-one-half, or termination of the plan without establishment of a successor plan (IRC Sec. 401(k)(2)(B)).

— After December 31, 1988, hardship withdrawals before the employee reaches age fifty-nine-and-one-half will be limited to the amount of elective contributions (IRC Sec. 401(k)(2)(B)(i)).

— Amounts deferred from taxation and contributed to the plans are fully vested (IRC Sec. 401(k)(2)(C)).

A distribution is on account of hardship only if it is made on account of an immediate and heavy financial need of the employee, and if it is necessary to satisfy such financial need. Generally, a distribution will be deemed to be made on account of an immediate and heavy financial need of the employee if it is on account of

— Payment of medical expenses of the employee or dependents.

— Purchase of a principal residence.

— Payment of tuition for next semester or quarter of post-secondary education for the employee or dependents.

— Payment of the funeral expenses of a family member.

Special discrimination tests allow highly compensated employees to have larger retirement plan benefits, as a percentage of compensation, than non-highly-compensated employees. Two alternative tests for discrimination are provided to prevent too large a disparity in deferral of income by highly compensated employees:

— The actual deferral percentage for highly compensated employees cannot be more than the actual deferral percentage for all other eligible employees multiplied by 1.25;

— The excess of the actual deferral percentage for the highly compensated employees over that of other eligible employees is not more than two percentage points, and the actual deferral percentage for the highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by two (IRC Sec. 401(K)(3)(A)(ii)).

Too large a disparity in participation is monitored by providing that employees eligible to participate (IRC Sec. 401(k)(3)(A)(i)) meet the requirements of the usual coverage tests (see section 3.2.5 of this manual). In addition, highly compensated employees are those who are highly compensated for the coverage tests. No more than one year of service, however, may be required in order to participate. Employee-elective contributions and those employer-nonelective contributions that satisfy the vesting and distribution restrictions may be taken into account to meet the special nondiscrimination rules.

If the plan fails to meet the nondiscrimination test, excess elective deferral and income attributable to such amounts are subject to a 10-percent excise tax unless distributed within two-and-one-half months of the plan year end (IRC Sec. 4979). The plan will not be disqualified if amounts are distributed before the end of the plan year in which the discrimination rules are violated (IRC Sec. 401(k)(8)).

NONDISCRIMINATION TABLE
I.R.C. SECTION 401(k) PREFERENTIAL DEFERRALS

Actual Aggregate Deferral Percentage of Compensation by Non-Highly-Compensated Employees	Maximum Permissible Deferral Percentage of Compensation by Highly Compensated Employees
1%	2 %
2%	4 %
3%	5 %
4%	6 %
5%	7 %
6%	8 %
7%	9 %
8%	10 %
9%	11.25%
10%	12.5 %

Although the arrangement must be part of a profit-sharing or stock bonus plan (or a money-purchase plan in existence on June 27, 1974, that included a salary reduction agreement), the employer does not have to have current or accumulated profits to make contributions to a profit-sharing plan (IRC Sec. 401(a)(27)). Tax-exempt or government employers, however, may not adopt a CODA (IRC Sec. 401(k)(4)(B)). Plans of tax-exempt employers adopted before July 1, 1986, or of state and local employers adopted before May 6, 1986, are grandfathered in.

Except by matching contributions, an employer may not condition contributions and plan benefits upon elective deferrals. This restriction includes voluntary contributions, and precludes the use of elective deferrals in order to satisfy minimum contributions under a top-heavy plan.

3.10 Employee Stock Ownership Plans

In recent years, particular attention has been given to employee stock ownership plans (ESOPs). An ESOP is a defined contribution plan that is both qualified and a stock bonus plan or a combination of a stock bonus and money-purchase plan, designed to invest primarily in qualifying employer securities (IRC Sec. 4975(e)(7)). Qualifying employer securities are common stock that is readily tradable on an established securities market. Special rules apply where there is no readily tradable common stock (IRC Sec. 409(1)). An independent appraiser must be used to value the securities in the latter case (IRC Sec. 401(c)(28)(C)).

ESOPs are designed to place the employer's stock ownership in the hands of a qualified trust for the benefit of the employees and their beneficiaries, thereby, presumably, creating an incentive for better job performance. In addition to their use as employee incentives, ESOPs

— Broaden the base of stock ownership.

— Help resist unfriendly takeover attempts.

— Can implement spin-offs of divisions.

— Can assist the employer corporation in raising capital.

— Can provide a tax deduction without any immediate cash outlay.

On the other hand, potential problems with ESOPs include

— Dilution of the present owners' control.

— Difficulty in valuing stock if closely held.

— Employee resentment if good earnings are not achieved.

Voting rights to the employer's stock are, in effect, passed through to the participants in the plan. A distinction is made between "registration-type" securities and other securities. Registration-type securities are generally required to be registered under Section 12 of the Securities Exchange Act of 1934. If the employer has a registration-type class of security, each participant must be allowed to direct how his or her allocated securities will be voted (IRC Sec. 409(e)(2)). If the employer has no such securities, each participant must be allowed to direct the vote on corporate matters with respect to approval or disapproval of merger, consolidation, recapitalization, reclassification, liquidation, dissolution, sale of substantially all assets, or similar transactions (IRC Sec. 409(e)(3)).

Qualified participants—those who have completed at least ten years of participation and have attained age fifty-five—must be allowed to direct the investment of at least 25 percent of their account during the five-year period beginning with the plan year after the participant attains age fifty-five (50 percent in the last year of the five-year period) (IRC Sec. 401(c)(28)(B)).

Unless elected otherwise by the participant, distribution from the plan must begin not later than one year after the plan year in which the participant separates from service because of attaining normal retirement age, or because of disability or death, or after five years if separation is for other reasons (IRC Sec. 409(o)(1)(A)). Unless the participant elects otherwise, distribution must proceed in substantially equal payments over a period not longer than the greater of:

— Five years, or

— Five years plus one additional year (but not more than five additional years) for each $104,470 by which the participant's account balance exceeds $522,350 (IRC Sec. 409(o)(1)(C)).

Participants entitled to a distribution from the plan have a right to demand that benefits be distributed in the form of employer securities (IRC Sec. 409(h)(1)). If the securities are not readily tradable, the employer must repurchase them or provide a 60-day put option (IRC Secs. 409(H)(1)(B) and 409(H)(4)). In certain cases, however, cash may be an acceptable medium for distribution (IRC Sec. 409(h)(2)).

Tax incentives are provided. Persons selling qualified securities to the plan may elect nonrecognition of long-term capital gain if, immediately after the sale, at least 30 percent of each class or of the total value of the corporation's stock is held by the plan (IRC Secs. 1042(a) and (b)). Qualified securities are employer securities issued by a domestic corporation that has no readily tradable stock outstanding (IRC Sec. 1042(c)(1)). Certain written statements must be provided, and the seller of the securities must then purchase qualified replacement property. If the seller is the estate of a decedent, 50 percent of the proceeds of the sale may be deducted from the value of the gross estate for purposes of determining estate tax (IRC Sec. 2057(a)), as long as no portion of the assets of the plan accrue to the benefit of that decedent or the estate for a ten-year period, nor to the benefit of anyone owning 25 percent or more of the corporation that issued the employer securities (IRC Secs. 409(n)(1)(A) and (B)).

For sales of nonpublicly traded stock after October 22, 1986 (generally conforming to the position taken in IRS Notice 87-13 (1987 IRB 14)), the securities must be assets includible in the gross estate if the decedent died during the shorter of the five-year period ending on the date of death or the period beginning October 22, 1986, and ending on the date of death. For sales to the ESOP after February 26, 1987, the amount of the deduction is limited to 50 percent of the taxable estate, but not more than $750,000.

There is no deduction to the extent that employer securities are acquired with transferred assets—that is, assets held by another qualified employer plan. There is an excise tax of 30 percent imposed if securities are acquired with proceeds of a loan, and transferred assets are used to make payment on the loan.

The deduction is not available unless the decedent owned the employer securities immediately before death and the employer securities are allocated to plan participants (or held for future allocation in connection with an exempt loan or a transfer of assets from a defined benefit plan) (IRC Sec. 4980(c)(3)). Failing to carry out this allocation results in an excise tax of 30 percent of the amount realized on disposition of the securities before allocation, if the proceeds are not allocated. Even if the proceeds are allocated, an excise tax of 30 percent is imposed if disposition of the securities occurs within three years from the date of purchase.

Banks and certain similar lenders may exclude from gross income 50 percent of the interest received with respect to loans that an ESOP uses to acquire employer securities (IRC Sec. 133(a)). Dividends are deductible by the paying corporation that maintains the ESOP if paid on stock held in the ESOP and paid in cash

- To the plan participants or their beneficiaries.
- To the plan and then distributed to the participants or their beneficiaries.
- To make payments on a loan incurred to purchase employer securities.

4. DEDUCTION LIMITS

An employer's contributions to a qualified plan must be ordinary and necessary business expenses. The IRS takes contributions or benefits into consideration also in judging whether total compensation paid to an employee is reasonable. Contributions that would otherwise be deductible pursuant to IRC Section 162 are limited in accordance with IRC Section 404. Complex carryover rules exist if an employer contributes an amount to a qualified plan that is in excess of the amount permitted to be deducted.

4.1 Pension Plans

The maximum deduction for contributions to a pension plan, whether a defined benefit or a money-purchase plan, is determined under any one of three alternative standards.

1. *Minimum funding.* The amount necessary to satisfy the minimum funding standard for the plan year ending within or with the employer's taxable year (or for any prior plan year).
2. *Level funding.* The amount necessary to provide all participants their remaining unfunded cost of past and current service credits distributed as a level amount or a level percentage of compensation over the remaining service of the employee. If more than 50 percent of the remaining unfunded costs is attributable to any three participants, the amounts attributable to such participants must be spread over at least five years.
3. *Past service funding.* The amount equal to the normal cost of the plan plus an amount necessary to amortize past service credits in equal annual installments over ten years.

The selection of the applicable standards is made on a year-by-year basis; that is, the employer can use whichever standard results in the largest deduction. In no event, however, may the employer deduct amounts in excess of the full funding limitation for the year, that is, the difference between the total plan liabilities and the present value of plan assets (IRC Sec. 404(a)(1)).

4.2 Profit-Sharing or Stock Bonus Plans

The maximum deduction for contributions to a profit-sharing or stock bonus plan for any taxable year is 15 percent of the compensation paid or accrued during the year to all participants. Total compensation is used to determine the limitations rather than any more restrictive definition. If an employer maintains more than one profit-sharing or stock bonus plan, or a profit-sharing plan and a stock bonus plan, the 15 percent limitation is applied to all such plans on a combined basis.

A profit-sharing plan does not need a definite formula for determining the amount of annual employer contributions. The plan may be so flexible as to state that the board of directors shall determine the amount of the contribution each year. However, a plan cannot be qualified as a profit-sharing plan unless the employer's contributions are contingent upon the existence of profits. The plan must have a definite, predetermined formula for allocating contributions among the participants and for distributing the funds accumulated under the plan.

4.3 Combined Plan Deduction Limits

If an employer maintains any combination of defined contribution and defined benefit plans, the total amount deductible in a taxable year cannot exceed the greater of 25 percent of the compensation of the participants or the amount necessary to satisfy the minimum funding standard of the defined benefit plan (IRC Sec. 404(a)(7)). This limit does not apply unless at least one employee participates in both plans. Thus, if the employer maintains two plans for two distinct groups of employees, the rules do not apply.

4.4 Plans for Self-Employed Persons

Self-employed persons can also participate in retirement plans. A self-employed individual is one who

— Has earned income for the taxable year.

— Would be self-employed except that the trade or business carried on by this individual had no net profits for the year.

— Has been a self-employed individual for any prior taxable year (IRC Sec. 401(c)(1)(A)).

The self-employed person's contributions are often based on a percentage of earned income. Earned income means net earnings from self-employment in a trade or business in which the personal services of the taxpayer are a material income-producing factor (IRC Sec. 401(c)(2)(A)).

Plans that cover self-employed persons are subject to the overall limits of IRC Section 415, as are all qualified plans (see section 3.7, herein). Thus, the maximum contribution is the lesser of $30,000 or 25 percent of earned income for defined contribution plans, and the maximum benefit is the lesser of $94,023, or the plan participant's average compensation for his or her three highest consecutive years. (IRC Sec. 415(b), (c)). For purposes of this calculation, earned income is calculated after the contribution has been made. It is often easier to use a 20 percent rate and apply it to earned income before the contribution is deducted. A benefit equal to earned income without regard to the contribution deduction is deemed to be reasonable for retirement plan limits (IRC Sec. 404(a)(8)(c)). The $94,023 limit is adjusted annually for inflation for years after 1987.

Contributions to stock bonus or profit-sharing plans on behalf of self-employed individuals cannot exceed the lesser of $15,000 or 15 percent of earned income from the trade or business for which the plan was set up. The 15-percent limit is figured upon the net, after deducting the contribution (IRC Sec. 404(a)(1)). This figure amounts to a 13.043

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percent allowable contribution, based upon income prior to the contribution. The limit for deductions for money-purchase pension plans is generally the lesser of $30,000, or the 20 percent contribution limit. There is a 10-percent nondeductible excise tax imposed on excess contributions.

4.5 Employee Stock Ownership Plans

Contributions paid into a trust forming part of an employee stock ownership plan, applied by the plan to the repayment of a loan incurred to acquire qualifying employer securities, are deductible not exceeding 25 percent of the employees' compensation (IRC Sec. 404(a)(9)(A)). There is no limit on the deductibility of contributions applied by the plan to the repayment of interest incurred to acquire qualifying employer securities (IRC Sec. 404(a)(9)(B)).

4.6 The Timing of Contributions

To be deductible, the contribution must be made either during the employer's taxable year or within the time for filing the employer's income tax return for the year, including extensions. The payment rule applies to both cash and accrual-basis taxpayers. A year-end accrual on the books and records by an accrual-basis taxpayer is not required. Effective for tax years beginning after December 31, 1986, a 10-percent excise tax is imposed on nondeductible contributions by an employer to a qualified plan (IRC Sec. 4972).

Payment by means of the employer's promissory note does not entitle the employer to a deduction contribution of a third-party promissory note unless certain conditions are met. Contributions of property are deductible, but may trigger taxable gain on appreciated property unless the property consists of employer stock.

5. TAXATION OF DISTRIBUTIONS

Three basic rules govern taxation of distributions from a qualified plan:

1. If the participant realizes no taxable income when the employer contributes to the plan, tax is incurred when the money is withdrawn.
2. If the participant incurs tax when the money is put into the plan, or if the participant contributes after-tax funds to the account, the money can be withdrawn without further tax.

3. It is possible to defer imposition of the tax at the time of distribution by causing the distribution proceeds to be transferred to another retirement vehicle.

Distributions can be made by various methods. The form of the distribution dictates how it will be taxed. Distribution may be made by

— A lump sum.

— A single sum.

— Installments over a fixed period.

— As an annuity payable for life or for joint and survivor life.

5.1 Lump-Sum Distributions

A lump-sum distribution is a distribution of the employee's entire balance in the plan and in similar plans maintained by the same employer, and made within a recipient's taxable year as well as

— On account of the employee's death.

— After the employee attains age fifty-nine-and-one-half.

— On account of the separation of service by a common-law employee.

— After a self-employed person has become totally and permanently disabled (IRC Sec. 402(e)(4)(A)).

A distribution to an employee does not qualify as a lump sum unless the employee is a participant for five or more taxable years (IRC Sec. 402(e)(4)(h)). If the distribution qualifies as a lump sum, the recipient can elect to

— Have the entire distribution taxed as ordinary income in the year of receipt.

— Defer the tax by transferring the monies to another qualified plan or IRA within sixty days of receipt.

— Defer part of the tax by transferring part of the monies to another qualified plan or IRA.

— Treat the distribution as ordinary income subject to a special five-year averaging provision, available to recipients who are over fifty-nine-and-one-half years and have not previously availed themselves of these special averaging provisions.

— Treat the portion of the distribution attributable to participation prior to 1974 as a long-term capital gain, subject to a five-year phase-out beginning with 1987.

Decreasing percentages will qualify for the maximum 20 percent capital gain rate, as follows:

1987	100%
1988	95%
1989	75%
1990	50%
1991	15%

Employees who elect the special averaging provision must apply these provisions to all distributions eligible for this treatment that are received in the year. A portion of a distribution cannot be rolled over while another portion is treated to the special averaging provision.

Special rules apply for recipients who attained age fifty prior to January 1, 1986. They may elect to have applied the capital gains provisions, including the maximum 20-percent rate in effect at that date, and avoid the requirement that a lump-sum distribution be received only after age fifty-nine-and-one-half. The recipient may also elect to have the ordinary income portion of the lump-sum distribution taxed under the existing ten-year averaging provisions. These rules apply whenever the distribution is received.

Beneficiaries of the estate of a deceased employee may exclude up to $5,000 from gross income if such payments are made by an employer and are paid by reason of the death of the employee. This "$5,000 death benefit exclusion" applies to a lump-sum distribution from a qualified stock bonus, pension, or profit-sharing trust.

5.2 Single-Sum Distributions

A distribution within one year of the employee's interest that does not qualify as a lump-sum distribution, because, for example, the employee has completed fewer than five years as a participant, is taxable in full as ordinary income (IRC Sec. 72). If, however, the distribution is made as a result of the termination of the plan or complete discontinuance of contributions, the monies can be rolled over to another qualified plan or to an IRA (IRC Sec. 402(a)(5)).

Partial distribution of at least 50 percent of the interest of the employee in the plan can be transferred in whole or in part to an IRA, but not to another qualified plan (IRC Sec. 402(a)(5)(D)). This treatment is available only to persons receiving distributions because of separation from service, death, or disability. The portion not transferred is subject to tax as ordinary income.

5.3 Installment Distributions

Installment distributions, whether for a fixed or an indeterminate period, are taxable in accordance with the annuity payment provisions. If the employee has made no nondeductible contributions to the plan, the entire amount of any payment is taxable as ordinary income on receipt. If the employee has made nondeductible contributions, the contributions are returned tax free.

Unless provisions of the plan in effect on May 5, 1986, permitted in-service withdrawal of employee contributions, some portion of any distribution will be taxable. Withdrawals from these plans are first treated as made from pre-1987 employee contributions. After these withdrawals, any additional distributions are taxed under pro rata recovery rules (IRC Sec. 72(e)(8)(D)).

If distributions are made before the annuity starting date, the nontaxable portion is determined by multiplying the distribution times a fraction, the numerator of which is the amounts contributed by the employee on an after-tax basis, and the denominator of which is the account balance (IRC Sec. 72(e)(8)(A)).

If distributions are made after the annuity starting date, the nontaxable portion is determined by multiplying the distribution times a fraction, the numerator of which is the amounts contributed by the employee on an after-tax basis, and the denominator of which is the total expected distribution calculated as of the annuity starting date (IRC Sec. 72(b)). In no event can more than the recipient's after-tax contributions be excluded. If the participant dies before recovering his or her contributions tax free, the remaining amount is deductible on the decedent's final income tax return, or is used by the beneficiary continuing to receive payments.

A special rule may provide more favorable treatment. Employee contributions made after tax are treated separately from employer contributions if earnings and losses on these two sources can be accounted for separately (IRC Sec. 72(e)(9)). Distributions can then be designated as originating from either the employee's after-tax portion or the employer's contribution portion. The nontaxable fraction for the employee's after-tax portion will usually be more favorable when computed separately in this manner.

5.4 Excise Tax on Premature Distributions

An additional income tax of 10 percent of the taxable amount is imposed on distributions from a qualified plan unless the distribution is made

— After the participant's reaching age fifty-nine-and-one-half.

— After the participant's death.

— As a result of disability.

— After age fifty-five and separation from service on account of early retirement under the plan.

— In the form of substantially equal periodic payments over the life or life expectancy of the participant (or the joint expectancy of the participant and a designated beneficiary), beginning on separation from service.

— To the extent of deductible medical expenses.

— From an employee stock ownership plan and before January 1, 1990 (IRC Sec. 729(t)).

Distributions made prior to March 15, 1987, on account of separation of service before January 1, 1987, are not subject to the excise tax provisions if the recipient elected to be taxed in 1986 on the distributions. Distributions that are rolled over tax free to an IRA or to another qualified plan are not subject to this tax. If the tax is avoided because substantially equal payments are made, these amounts cannot be changed until the individual is age fifty-nine-and-one-half, or has been receiving payments for five years, whichever occurs later (IRC Sec. 72(t)(4)).

5.5 Excise Tax on Large Distributions

A 15-percent excise tax is imposed on aggregate annual retirement plan distributions in excess of the greater of $150,000 or $117,529, effective January 1, 1988. This limit will be adjusted annually for cost-of-living increases. (IRC Sec. 4981A). For a lump-sum distribution, the ceiling is increased to $750,000. To determine if this tax applies, all distributions (whether or not from related employers, and including individual account distributions) are aggregated.

If the employee elects this transition rule, the tax will not apply to distributions of amounts accrued before 1987. An employee must have an accrued balance of $562,500 on August 1, 1986, to be able to elect this provision. Any amounts in excess of $117,529, however, that are not protected by reason of pre-1987 accrual will be taxable (IRC Sec. 4981A(c)(5)).

If an individual dies with assets in retirement arrangements that, without penalty, exceed the amount available for distribution, and assuming payments were made over the life expectancy that remained on the day before death, an additional estate tax is imposed equal to 15 percent of the excess. The unified estate and gift tax credit and the marital deduction are not available to decrease this tax. Pending technical corrections would allow the spouse to elect not to have these provisions apply until the death of the spouse.

5.6 Required Distributions

Distributions of benefits must commence by April 1 following the calendar year in which the participant attains age seventy-and-one-half, or (in the case of participants who are not 5-percent owners) when the participant retires (IRC Sec. 401(a)(9)). If a qualified plan fails to meet the distribution rules, it will be disqualified. However, for plan years beginning after December 31, 1988, a plan will not be disqualified when there are isolated instances when the distribution rules under IRC Section 401(a)(9) are not satisfied. After December 31, 1988, benefits must commence by April 1 following the calendar year in which the participant reaches age seventy-and-one-half years, without regard to the date of retirement. Otherwise, a 50-percent excise tax is imposed on amounts required to be distributed, and disqualification of the plan will not occur.

In the event of the employee's death, the remaining interest must be distributed within five years after the employee's death, or the death of the surviving spouse (IRC Sec. 401(a)(9)(B)(ii)). If joint and survivor payments began before death, they can continue under the same schedule previously used (IRC Sec. 401(a)(9)(i)). If payments have not begun before death (though the participant designated a beneficiary to receive payments for life, beginning within one year of death), distributions can be made over the beneficiary's life expectancy (IRC Sec. 401(a)(9)(iii)).

A surviving spouse who receives a lump-sum distribution may transfer all or any portion of the distribution to either an IRA or another qualified plan. The surviving spouse can also delay any distribution until the year in which the participant would have been age seventy-and-one-half (IRC Sec. 401(a)(a)(iv)).

Distributions from a qualified plan are subject to estate taxes to the extent that the payments qualify for the marital deduction.

5.7 Loans Treated as Distributions

Some plans permit a participant to borrow from the plan. The following reasons suggest that a participant in need of funds should borrow from the plan rather than from a bank or his or her closely held corporation.

— As in the case of a bank loan, the borrower realizes no income when he or she borrows the money and, in certain cases, can deduct interest paid. A loan can be made to an owner-employee from a qualified plan if the Department of Labor grants an exemption from the prohibited transaction rules. Since an owner-employee is considered a key employee, no deduction is allowed for any interest paid, regardless of the use of the loan proceeds (IRC Section 72(p)).

— Unlike a banker, a plan trustee may accept the participant's vested interest as collateral.

— Monies paid as interest, although deductible, if paid to a bank represent a permanent outflow of capital, but, if paid to the plan, are available for the economic benefit of the participant.

— Loan interest can represent a stable source of plan investment income in an otherwise speculative investment environment.

— Unlike a loan from a closely held corporation to a shareholder, which may be re-characterized as a dividend, a plan loan cannot be characterized as a dividend.

Restrictions limit the size of loans that can be made tax free under a de minimis rule. If not otherwise prohibited, loans are tax free if, when aggregated with other plan loans, they do not exceed the lesser of

— $50,000, reduced by the excess of the highest outstanding loan balance during the preceding one-year period, or the outstanding balance on the date a new loan is made, or

— The greater of 50 percent of the vested account balance of the employee or $10,000 (IRC Sec. 72(p)).

Loans that are not, by their terms, repayable within five years are not allowed as tax-free distributions under this rule, unless the loan is used to acquire a dwelling unit used as the principal residence of the participant (IRC Sec. 72(p)(2)(B)). For loans made, renewed, renegotiated, modified, or extended after December 31, 1986, substantially level amortization, with payment made at least quarterly, is required. Loans made prior to 1987 have no required amortization (see section 6.2 of this chapter.)

6. FIDUCIARY RESPONSIBILITIES

A *plan fiduciary* is an individual who exercises discretionary authority, control, and responsibility in the management or administration of an employee benefit plan or in the management or disposition of its assets. A fiduciary renders investment advice to the plan for direct or indirect compensation. (ERISA Sec. 21(A)). Fiduciaries are personally liable for any plan losses resulting from a breach of fiduciary duties as well as for surrendering any profits made through improper use of plan assets. With some exceptions, every fiduciary and every person who handles plan assets must be bonded (ERISA Sec. 412).

6.1 Obligations

Under the plan, fiduciaries must discharge their duties solely in the interest of participants and beneficiaries

— For the exclusive purpose of providing benefits to the participants and their beneficiaries while defraying expenses for administering the plan.

— With the care, skill, prudence and diligence used by a person familiar with the conduct of an enterprise with similar character and aims.

— By diversifying the investments of the plan to minimize the risk of large losses, unless prudent not to do so.

— In accordance with the documents and instruments governing the plan that are consistent with ERISA (ERISA Sec. 404).

If a plan has more than one fiduciary, and a breach of fiduciary duties has been made by another fiduciary, it is not sufficient that the other fiduciaries refuse to participate in the breach and then resign, but rather each fiduciary must attempt to remedy the breach (ERISA Sec. 405).

6.2 Prohibited Transactions

In addition to bearing general fiduciary obligations, a fiduciary is restricted from allowing the plan to engage in certain specific transactions. For example, unless an exemption applies, the fiduciary may not cause the plan to engage in any transaction that constitutes a direct or indirect

— Sale, exchange, or leasing of any property between the plan and a party-in-interest.

— Lending of money or other extension of credit between the plan and a party-in-interest.

— Furnishing of goods, services, or facilities between the plan and a party-in-interest.

— Transfer to, or use by or for the benefit of, a party-in-interest of any assets of the plan.

— Acquisition, on behalf of the plan, of any employer real property or employer security, except for "qualified" real property or securities not in excess of 10 percent of plan assets in certain plans (ERISA Sec. 406; IRC Sec. 4975).

Parties-in-interest include

— Any fiduciary or counsel to the plan.

— Any person providing services to the plan.

— The sponsoring employer.

— The labor union representing plan participants.

— Any employee, officer, director, or 10-percent-or-more shareholder of a service provider, the sponsoring employer, or labor union.

— Certain relatives of other parties-in-interest.

— Certain related business organizations and their owners (ERISA Sec. 3(14); IRC Sec. 4975(e)(2)).

Because the prohibited transaction rules cover literally all dealings with parties-in-interest, various statutory and administrative exemptions are provided. The principal statutory exemptions are the following:

— Loans to plan participants (ERISA Sec. 408(b)(1); IRC Sec. 4975(d)(1)).

— Reasonable arrangements for services if no more than reasonable compensation is paid (ERISA Sec. 408(c)(2); IRC Sec. 4975(d)(10)).

— Receipt by a fiduciary of any benefit to which he or she is entitled as a participant (ERISA Sec. 408(c)(1); IRC Sec. 4975(d)(9)).

A loan to a participant is a prohibited transaction unless the loan

— Is available to all participants on a reasonably equivalent basis.

— Is not made available to members of the prohibited group in amounts greater than those available to rank-and-file employees.

— Is made in accordance with specific plan provisions.

— Bears a reasonable rate of interest.

— Is adequately secured (the loan can be secured by the participant's vested interest in the plan) (ERISA Sec. 408(b)(1); IRC Sec. 4975(d)(1)).

A loan to an owner-employee in a plan covering a self-employed person, to a 5-percent-or-more shareholder-employee in a plan of an S corporation, or to any family members failing to satisfy these requirements is always prohibited. A loan to a participant, which is promptly loaned by the participant to the employer, may be considered a prohibited indirect loan by the plan to the employer. Participant loans, even if exempt, are monitored by the IRS through required disclosure on the Form 5500 series.

If a statutory exemption is not available, an administrative exemption may be requested. Certain transactions of a recurring nature have been exempted administratively through so-called "class exemptions." Two important class exemptions permit the purchase and sale of life insurance policies between the plan and the insured participant.

A 5-percent nondeductible penalty tax is imposed upon the party-in-interest (disqualified person) who participates in the prohibited transaction. If the transaction cannot be corrected by placing the plan in a good financial position as if the party-in-interest had acted using the highest fiduciary standards, a 100-percent nondeductible penalty is imposed. In certain cases there will be a warning (IRC Sec. 4961(A)). The penalty taxes are reported on IRS Form 5330.

6.3 Plan Investments

Plan investments of an employee pension benefit plan are subject to the various fiduciary standards imposed by Title I, Part 4, of ERISA. These standards include the specific requirement, unless prudent not to do so, to diversify the investments of the plan so as to minimize the risk of large losses. Subject to these general fiduciary requirements, if an investment is not within the ambit of the specific prohibited transaction rules set forth in Section 406 of ERISA, the investment is permissible under Title I of ERISA.

The Internal Revenue Code similarly does not set forth specific rules governing the types of investments that may be made by a qualified plan. Nevertheless, the code sometimes indirectly precludes a particular investment by subjecting it to tax. For example, an investment in collectibles (such as works of art, rugs, antiques, metals, gems, stamps, coins, whiskey, and the like) by an individually directed account in a qualified plan is treated as a distribution to the participant in an amount equal to the cost of the collectible (IRC Sec. 408(m)). Collectibles are not precluded as investments in a defined benefit pension plan or in any defined contribution plan that does not permit a participant to direct the investment of his or her account. As a practical matter, however, a plan in which the sole participant is also the plan trustee can invest in the collectibles desired by the participant and avoid this restriction.

One troublesome aspect of collectibles is the requirement that the assets of the plan be valued at current value each year. Some arrangement for an annual appraisal is therefore necessary. Collectibles also tend to appreciate in value and are not generally income-producing. These investments can also result in a prohibited transaction if the collectible is used by the participant (for example, through storage of artwork in the participant's home or office).

The tax on unrelated business taxable income further restricts certain investments by making the profit realized from the investment taxable in whole or in part while in the plan. Investments subject to tax on unrelated business taxable income fall into the two following categories:

— Income from unrelated trades or businesses. The imposition of tax on unrelated trade or business income is intended to eliminate a source of unfair competition by tax-exempt organizations by placing the unrelated business activities on the same tax basis as businesses that are subject to tax. An investment that may result in the surprise imposition of the tax is a limited partnership interest.

— Income from debt-financed property. The imposition of tax on debt-financed property is intended to limi' the ability of tax-exempt organizations to leverage investments. The purchase of stock on margin exemplifies an investment subject to the tax. Borrowings to purchase employer stock by an employee stock ownership plan are not, however, considered debt-financing for purposes of the tax (IRC Sec. 514(c)(8)). Certain loans that are used to acquire real property are also exempted (IRC Sec. 514(c)(9)).

The possible imposition of a tax does not by itself preclude a particular investment. The decision to make such an investment should focus on the net return after the tax instead of on the return from a more traditional investment.

Finally, the tax-exempt character of the plan itself affects certain investment decisions. For example, trustees do not purchase tax-exempt municipal bonds because they yield a lower interest return than other bonds. Developed real estate is uncommon as a plan investment because the depreciation or cost-recovery deductions and real estate tax deductions are of little value to a tax-exempt entity. Participating equity mortgages, however, are currently in vogue. On the other hand, some investments are structured specifically for tax-exempt entities. Zero coupon bonds, for example, which yield no cash until maturity but cause the owner to realize imputed interest income, are common investments of plans because of the high yields to be ultimately realized.

Profit-sharing and other individual account plans can invest more than 10 percent of their portfolios in employer securities only if the plan explicitly so provides (ERISA Secs. 407, 408(e)).

However, heavy investment in the employer's securities:

— May be inconsistent with prudent, diversified investment management.

— May prove to be an illiquid investment because of the trustee's reluctance to "unload" the shares.

7. REPORTING AND DISCLOSURE

Documents required upon adoption of the plan are the following:

— Resolutions that approve the adoption of the plan and trust, establish the IRC Section 415 limitation year, and appoint plan fiduciaries.

— Plan and trust documents.

— Applications for employer identification numbers for plan and trust and for plan administrator.

— Summary plan description.

7.1 Procedures for Seeking IRS Approval

The following documents are required upon submission of the plan to the Internal Revenue Service:

— IRS Form 5300 for defined benefit plans or IRS Form 5301 for defined contribution plans.

— IRS Form 5302 (employee census).

— Notice to Interested Parties.

Approval of the plan documents by the Internal Revenue Service is not required.

7.1.1 Advantages of master, prototype, or uniform plans

Creation of a plan and its processing for qualification by the IRS is easier if the plan is put together with uniform or standard provisions. Master and prototype plans have traditionally been assembled or *sponsored* by trade associations, banks, insurance companies, regulated investment companies, and professional associations. Revenue Procedure 84-23 details procedures for securing an opinion letter indicating IRS approval.

Master plans include descriptions and agreements for funding. Prototype plans leave this detail to the employer who adopts the plans. Within both categories, plans can be in standardized or variable form, depending on how much choice about plan aspects is left to the adopter. Approval by the IRS, in the form of an opinion letter, is sought through Form 4461 for defined contribution plans and through Form 4461-A for defined benefit plans.

A uniform plan may be offered by any sponsor having at least ten client adopters in an IRS region. Instructions may be found in Revenue Procedure 84–86. The sponsor secures a notification letter from the IRS regarding the plan, then the adopter (employer) secures a determination letter. The IRS will not approve uniform plans for

— Government or church plans.

— Stock bonus plans.

— Collectively bargained plans.

— Employee stock ownership plans.

— IRC Section 403(b) annuities.

7.1.2 Determination letters

Determination letters are issued by the IRS to confirm that a plan qualifies under IRC Section 401(a) and that the trust is exempt from taxation under IRC Section 501. It is not necessary to secure a determination in advance of operation in order to secure a tax deduction, but it is prudent to do so. Revenue Procedure 87-1 sets out the general procedure to be followed.

7.1.3 Procedures for filing and appeal

Of the Internal Revenue Service's district offices, ten are designated as key districts, charged with responsibility for issuing determination letters for the qualification of pension and other retirement and deferred income plans. In each of these districts there is an Office of Employee Plans and Exempt Organizations (EP/EO). At the regional level, an assistant regional commissioner for EP/EO matters handles appeals related to plan determination matters.

Form 5300 or 5301 is filed with the appropriate IRS key district director. In most cases, specific plan amendments are suggested and the employer adopts these amendments. If the applicant has exhausted the administrative remedies, the ultimate appeal procedures are to the Tax Court. Single-employer plans are filed with the key district director for the district in which the employer's (or sponsoring employee organization's) place of business is located. For multi-employer plans, applications are filed in the district where the sponsor's principal place of business is located.

During consideration by the key district office, the applicant (or the key district office itself) may request technical advice from the national office of the IRS. If an adverse decision is anticipated, the applicant has the right to one conference with the national office.

In order to trigger an applicant's right of appeal, the key district director issues the applicant a notice of a proposed adverse determination, whereupon the applicant may request review by the IRS regional office. This review is requested by submitting a written request to the key district director within thirty days of the notice of the proposed adverse ruling. The key district director forwards the request to the regional office, where the applicant can request a conference. Unless the applicant does request regional office review, he will be deemed not to have exhausted his administrative remedies, and subsequent access to the Tax Court will be denied. If regional office review is requested and the review is favorable to the applicant, the key district office will issue a determination letter.

If the regional office will not issue a favorable decision, the applicant has recourse to the national office of the IRS. A written request must be filed within thirty days of the regional office's decision for this final phase of administrative procedures.

To justify review by the national office, sufficient cause must be asserted that issues in this case are unique or novel without any published precedent or that the IRS position is

— Contrary to law or regulations.

— Contrary to published precedent.

— Contrary to a court decision in which the IRS has acquiesced.

— In conflict with a determination in another region.

If the national office review is unsatisfactory, a declaratory judgment may be sought from the Tax Court. Certain conditions prerequisite to the appeal to the court can be found in IRC Section 7476:

— An adverse determination has been received with respect to an initial or continuing qualification.

— There has been a failure by the secretary of the Treasury to make any determination.

In practice, the Tax Court has evidenced a reluctance to exercise jurisdiction. It is particularly important to adhere to the administrative routine beginning with filing at the district level through regional and national office review. Additionally, there are five conditions necessary to petition the Tax Court, called *limitations* in IRC Section 7476(b):

— The plan has been put into effect.

— The petitioner is the employer, the plan administrator, an employee qualified under prescribed regulations as an interested party, or the Pension Benefit Guaranty Corporation.

— All administrative remedies available to the petitioner have been exhausted (and at least 270 days have expired since the request for determination was made).

— The petitioner convinces the court he has properly provided interested persons with notice of his filing of the request for a determination.

— The petition is filed within ninety days after the final administrative determination. (If no determination has been made, the petition must be filed within ninety days after the expiration of the 270-day period.)

7.1.4 Locations of key district offices

If the principal office of the plan sponsor is located in the following IRS district	Send application to the address below
Atlanta, Birmingham, Columbia, Greensboro, Jackson, Jacksonville, Little Rock, Nashville, New Orleans	Internal Revenue Service EP/EO Service Unit P.O. Box 941, Room 310 Atlanta, GA 30370
Baltimore, Pittsburgh, Richmond, U.S. possessions, or a foreign country	Internal Revenue Service EP/EO Division P.O. Box 10710 Baltimore, MD 21203
Brooklyn, Albany, Augusta, Boston, Buffalo, Burlington, Hartford, Manhattan, Portsmouth, Providence	Internal Revenue Service EP/EO Division P.O. Box C-9050 General Post Office Brooklyn, NY 11202
Chicago, Aberdeen, Des Moines, Fargo, Helena, Milwaukee, Omaha, St. Louis, St. Paul, Springfield	Internal Revenue Service EP/EO Division P.O. Box A:3617 Chicago, IL 60690
Cincinnati, Cleveland, Detroit, Indianapolis, Louisville, Parkersburg	Internal Revenue Service EP/EO Division P.O. Box 3159 Cincinnati, OH 45201
Dallas, Albuquerque, Austin, Cheyenne, Denver, Houston, Oklahoma City, Phoenix, Salt Lake City, Wichita	Internal Revenue Service EP/EO Division Mail Code 306 1100 Commerce St. Dallas, TX 75242

If the principal office of the plan sponsor is located in the following IRS district	Send application to the address below
Los Angeles, Honolulu, Lagena Niguel	Internal Revenue Service EP Application Receiving P.O. Box 536 Los Angeles, CA 90053-0536
Newark, Philadelphia, Wilmington	Internal Revenue Service EP/EO Division P.O. Box 1680 Newark, NJ 07101
San Francisco, Las Vegas, Sacramento, San Jose	Internal Revenue Service EP/EO Division Box 36040 Stop 3-2-29 450 Golden Gate Ave. San Francisco, CA 94102
Seattle, Anchorage, Boise, Portland	Internal Revenue Service EP/EO Division 915 Second Ave. Mail Stop 554 Seattle, WA 98174

7.2 Annual Reporting

Documents required in administration of the plan are

— Designation of beneficiary.

— Employee census forms.

— Annual report (IRS Form 5500, 5500-C, 5500-R or 5500 EZ), due seven months after the end of the plan year. The following four documents are various forms that may need to be attached to the annual report:

IRS Form 5500-P

IRS Form 5500, Schedule A, for insured plans

IRS Form 5500, Schedule B, for defined benefit pension plans

IRS Form 5500, Schedule SSA, for deferred vested participants

— Summary annual report, disclosed to plan participants within 210 days after the end of the plan year.

— Resolutions authorizing annual plan contributions (required by the time the contribution is due).

Miscellaneous documents required periodically are

— Resolutions amending the plan.

— Summary of material modifications in plan (filed with the Department of Labor within sixty days of the change and with participants within 210 days after the end of the plan year).

— Updated summary plan descriptions (filed with the Department of Labor and plan participants every five years or, if no changes have been made, every ten years).

— IRS Form 5310, filed thirty days before a plan merger or transfer of assets and liabilities.

Documents required in the event of distribution are

— IRS Form W-4P.

— IRS Form W-2P, for periodic distributions.

— IRS Form 1099-R for lump-sum distributions.

Documents required upon plan termination are

— Resolutions regarding plan termination.

— IRS Form 5310, application for IRS approval (if desired, but the form may also be used to notify Pension Benefit Guaranty Corporation of plan termination).

A penalty payable to the participant of $100 for each day compliance is delayed may be imposed for failure to provide any plan participant with any information he is entitled to receive within thirty days of written request.

In addition, numerous penalties for failure to file IRS forms in a timely manner may be imposed, including

— $25 for each day the Form 5500 is late.

— $1,000 for failure to file Form 5500, Schedule B.

— $1 for each participant, for each day, for failure to file Form 5500, Schedule SSA.

8. SIMPLIFIED EMPLOYEE PENSION PLANS (SEPs)

An employer may contribute to an IRA established by an employee for employer contributions. Alternatively, the employer can adopt an *SEP*. Simplified employee pensions are intended as alternatives to qualified plans, particularly for smaller businesses. Attractive features include ease of administration and complete employer discretion as to whether a contribution will be made (and also its desired size). An SEP is a retirement plan that includes many features of a qualified plan and that uses an IRA as the funding vehicle (IRC Sec. 408(k)). Beginning in 1987, SEP contributions are excluded from an employee's income. These contributions are no longer included in an employee's wages for income tax purposes. It follows that employees can no longer take a deduction for the SEP contributions. For example, an employee's normal 1988 compensation is $20,000. In addition, his or her employer contributes $2,000 to a SEP plan. The employer will show total wages of $20,000 on the employee's Form W-2. A model agreement is available from the IRS, as Form 5305-SEP, but may not be used by an employer maintaining another qualified plan, nor by one that has ever had a defined benefit plan.

8.1 Qualification Requirements

Contributions to an SEP must be fully vested when made. For every year the employer makes an SEP contribution, the employer must contribute to the account of each employee who

— Has reached age twenty-one;

— Has performed services for the employer during at least three of the five preceding calendar years; and

— Has received at least $313 in compensation for the year (IRC Sec. 408(k)(2)).

Contributions cannot discriminate in favor of highly paid employees. Only compensation of $208,940 per individual can be considered in applying the nondiscrimination tests. If the SEP is top-heavy, the minimum contribution requirements must be met. (See section 3.8 of this chapter.)

8.2 Deduction Limits

Employer contributions are deductible up to 15 percent of each employee's compensation.

8.3 Taxation of Distributions

An employee must not be prohibited from immediately withdrawing employer contributions to an SEP. Certain withdrawals, such as those prior to age fifty-nine-and-one-half or due to disability or death, result in an imposition of a 10-percent penalty (IRC Sec. 72(t)). (See section 5.4 of this chapter.) Distributions from an SEP are taxed as ordinary income unless rolled over to another IRA within sixty days of receipt of the distribution (IRC Sec. 408(d)(3)(A)).

8.4 Elective Contributions to an SEP

Beginning in 1987, an employer can allow employees a choice of receiving cash or a contribution to an SEP. Elective deferrals of income into an SEP are subject to a $7,313 maximum and must be coordinated with any IRC Section 401(k) deferrals. Discrimination rules similar to those for CODAs apply, including the excise tax on excess contributions. (See section 3.9 of this chapter.)

9. OTHER TYPES OF PLANS

Although defined benefit pension plans and defined contribution plans are the two broad categories of qualified retirement loans, variations on the basic themes are common.

9.1 Thrift or Savings Plans

Any basic plan may permit (or require) employee contributions. Providing for employee contributions is beneficial to both employee and employer. Employees benefit through avoidance of income tax on earnings on their invested savings, while increasing the funds they have available for retirement or for an emergency. Employers are pleased when employees share in the cost of their own retirement, reducing the amounts that might otherwise be required from the employer. Some typical characteristics of thrift plans are the following:

- Payroll deductions
- Company contributions conditioned upon both profits and employee contributions
- Low-cost operation to the employer
- Enthusiastic support from employees
- Can be used to supplement defined benefit plans (pensions)
- Investment of at least a portion of their assets in employer stock

Some of the *advantages* of thrift plans are

— Higher benefits can be provided because the employee contributions supplement employer contributions.

— Employees are encouraged to create savings to be available in case of their death, disability, or termination of employment.

— Cooperation is enhanced between employee and employer.

— Contributing to the plan keeps an employee aware of its existence and more appreciative of its benefits.

Thrift plans have some *disadvantages*:

— If the rationale for the plan is not communicated to employees, they may resent the reduction in their take-home pay or if given the choice, not contribute to the plan.

— Added cost is incurred by the employer in enrolling employees, collecting contributions, keeping records, and handling disputes.

— If employees do not elect to participate, overall participation and discrimination tests may not be met. (See section 3.2.2 of this chapter.)

In profit-sharing plans, employee contributions are usually made voluntarily. Mandatory contributions by employees to any kind of plan as a condition of their participation in a qualified plan must not be so burdensome that lesser-paid workers fail to participate, thus making the plan discriminatory (Treas. Regs. Sec. 1.401-3, 4). Also, after 1986, new nondiscrimination rules effectively preclude employee contributions by highly compensated employees unless contributions are made by non-highly-compensated employees.

9.2 Stock Bonus Plans

A stock bonus plan is a plan established and maintained by an employer to provide benefits similar to those of a profit-sharing plan. Contributions by the employer, however, are not necessarily dependent upon profits, and benefits are ordinarily distributable in stock of the employer company. Rules on allocating stock to participants' accounts and distributing stock are similar to those covering profit-sharing plans.

If the employer's stock is not publicly traded, and more than 10 percent of the plan's total assets are securities of the employer, certain voting rights of the employer's stock are, in effect, passed through to the participants. A distinction is made between registration-type securities and other securities. Registration-type securities are generally those required to be registered under Section 12 of the Securities Exchange Act of 1934. If the employer has a registration-type class of security, each participant must be allowed to direct how his or her allocated securities will be voted (IRC Sec. 409(e)(2)). If the employer has no such securities, each participant must be allowed to direct the vote on corporate matters with respect to approval or disapproval of merger, consolidation, recapitalization, reclassification, liquidation, dissolution, sale of substantially all assets, or similar transactions (IRC Sec. 409(e)(3)).

Unless elected otherwise by the participant, distribution from the plan must begin not later than one year after the plan year in which

(Text continued on page 169

the participant separates from service because of attaining normal retirement age or because of disability or death, or after five years if separation is for other reasons (IRC Sec. 409(o)(1)(A)). Unless the participant elects otherwise, distribution must proceed in substantially equal payments over a period not longer than the greater of

— Five years, or

— Five years plus one additional year (but not more than five additional years) for each $100,000 by which the participant's account balance exceeds $500,000 (IRC Sec. 409(o)(1)(C)).

Participants entitled to a distribution from the plan have a right to demand that benefits be distributed in the form of employer securities (IRC Sec. 409(h)(1)). If the securities are not readily tradable, the employer must repurchase them or provide a 60-day put option (IRC Secs. 409(H)(1)(B) and 409(H)(4)). In certain cases, cash may be an acceptable medium for distribution (IRC Sec. 409(h)(2)).

9.3 Money-Purchase Pension Plans

Money-purchase pension plans are defined contribution pension plans that must meet the rules of IRC Section 401(a) relating to pensions. Money-purchase pension plans have these characteristics:

— Specified contributions, typically of either a specified amount or a percentage of an employee's compensation, are made annually by the employer.

— Contributions must be definitely determinable, and thus cannot be based on profits nor otherwise be under the employer's discretion (Rev. Rul. 72-302).

— Employer contributions cannot be based on an employee's discretionary contributions.

— Contributions plus the earnings thereon are used to purchase benefits in the form of an annuity, the terms of which are set by actuarial means, although lump sums may be distributed.

— To aid older employees, years of service may be integrated into the formula that determines contributions. The operation of this feature must not result in prohibited types of discrimination, for example as a consequence of lower turnover among officers, major shareholders, and other highly compensated employees.

— Participants may withdraw only their own contributions (and the earnings thereon), but may not do so to the extent that employer contributions are based thereon.

Forfeitures may be (but need not be) reallocated to the remaining plan participants, or may be used to reduce future employer contributions (IRC Sec. 401(a)(8)).

9.4 Target Benefit Plans (Hybrid Plans)

A target benefit plan is a type of money-purchase pension plan. A target benefit plan is a defined contribution plan in that an individual account is maintained for each participant. Benefits, however, must be definitely determinable in the form of a target or objective, as in a benefit plan. There are other similarities to defined benefit plans:

— Benefits must be definitely determinable.

— Benefits are based on actuarial assumptions, with an objective or *target* stated for each participant.

— Forfeitures may be reallocated to other participants.

— Employer contributions are not discretionary.

— Contributions may not be conditioned on profitability.

Target benefit plans are similar to defined contribution plans as well in that

— ERISA requirements for actuarial reports do not apply.

— Individual accounts for participants must be maintained.

— Benefits are based on the amounts that can be purchased from a participant's individual account.

— Defined contribution plan limits apply for maximum contributions and benefits (IRC Sec. 415).

— Insurance by the Pension Benefit Guaranty Corporation is not required.

— Contributing to the plan keeps an employee aware of its existence and more appreciative of its benefits.

Thrift plans have some disadvantages:

— If the rationale for the plan is not communicated to employees, they may resent the reduction in their take-home pay, or if given the choice, not contribute to the plan.

— Added cost is incurred by the employer in enrolling employees, collecting contributions, keeping records, and handling disputes.

— If employees do not elect to participate, overall participation and discrimination may not be met. (See section 3.2.2 of this chapter.)

In profit-sharing plans, employee contributions are usually voluntarily made. Mandatory contributions by employees to any kind of plan, as a condition of their participation in a qualified plan, must not be so burdensome that lesser-paid workers fail to participate, thus making the plan discriminatory (Treas. Regs. Sec. 1.401-3, 4).

10. ACCOUNTING FOR PENSION PLANS

Generally accepted accounting principles, used by employers as a guide for their accounting for employee defined benefit pension plans, were completely changed by Statements of Financial Accounting Standards Nos. 87 and 88. Implementation of these standards is not required until 1987 (1989 for some small companies) for calendar-year reporting. Recognition of the minimum liability (discussed below) is not required until 1989. These pronouncements settle three major accounting issues:

— How much pension expense should be charged annually?

— What assets and liabilities should appear on the company's balance sheet?

— What disclosures are necessary?

10.1 Calculation of Pension Expense

Annual pension expense is determined as a function of the following five factors:

1. Service cost, also called *normal cost,* determined actuarially as the present value of benefits attributed to employee service during the period. If future compensation levels are incorporated in the benefit formula, then the "benefits/years-of-service" approach, which uses future pay, must be the basis for this period's cost. (Pension liability calculated under the benefits/years-of-service approach—called the *projected benefit obligation* rather than the *accumulated benefit obligation*—is based on current pay levels and used for calculating minimum liability.)
2. Interest accrued on the present value of the projected benefit obligation outstanding during the period.
3. The actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and the end of the period, adjusted for benefit payments and contributions.
4. Prior service cost (resulting from plan amendments) or unfunded liability at adoption, as amortized, whether as a declining charge or a straight-line charge.

5. Gains and losses as a result of differences between expected and actual experience in respect of both assets and liabilities. Gains and losses measure the effect of the plan's experience on assumptions used, including return on plan assets, mortality experience, employee turnover, and salary levels.

Gains and losses reflecting differences between expected and actual values might be significant in dollar amounts. To prevent wide fluctuations that might be caused by these differences, the "corridor approach" is used. The corridor approach requires amortization over the remaining service period of active employees of gains and losses in excess of 10 percent of the greater of the projected benefit obligation or the market-related asset value. Certain single-occurrence gains and losses that might arise from the closing of a plant or from providing termination benefits in conjunction with a reduction in workforces or the discontinuance of a business segment are to be recognized as part of the immediate effect of the occurrence.

The extent of gains and losses on plan assets is measured by the "market-related" approach, which encompasses use of a moving average of asset values over a period of time. The time horizon and the weighing scheme are both somewhat a matter of the management's choice.

To the extent that pension expense is overfunded or underfunded annually by asset contributions, prepaid pension cost (asset) or accrued pension cost (liability) accounts will be created.

10.2 Minimum Liability

A liability must be recognized when the accumulated benefit obligation exceeds the fair value of the plan assets. The account to be debited as this liablity is recognized is an intangible asset called, perhaps, *deferred pension cost.* If an accrued pension cost or *liability,* account already exists, only the additional liability to bring the total up to the minimum needs to be recorded. No asset may be recorded if the fair value of the assets exceeds accumulated benefit obligation.

10.3 Financial Statement Presentation and Disclosures Required

Excess of pension expense over amounts funded appears as a long-term liability, while an asset is shown when plan contributions exceed expense. After 1988, an additional liability appears if accumulated benefit obligation exceeds fair value of the plan assets. The debit is normally to an intangible asset account. If this debit is greater than the unrecognized prior service cost, the excess is reported as a contra account to stockholders' equity. Footnotes must include the following:

— A description of the plan, including groups covered, type of benefit formula, funding policy, assets held, and nature and effect of significant matters affecting comparability among the periods presented.

— The components making up net pension expense for the period.

— A reconciliation of the funded status of the plan with the amounts reported in the balance sheet, showing the amount of

Plan assets at fair value.

Projected benefit obligation.

Unrecognized prior service cost.

Unrecognized net gain or loss.

Any remaining unrecognized net obligation or net asset existing at the date of initial application of FASB No. 87.

Additional liability recognized.

Prepaid pension cost or accrued pension cost recognized.

10.4 Amortization of Transition Amounts and of Prior Service Costs

Amortization is required for the transition amount that comes about when companies switch to the new standards (that is, from FASB No. 8 to FASB No. 87). The transition amount is the difference between the projected benefit obligation and the fair value of the plan assets (an unrecognized net asset or net obligation). Straight-line amortization is made over the greater of the average remaining service life of current participants in the plan, or, if the employer so elects, fifteen years.

10.5 Accumulated Versus Projected Benefit Obligation

For different purposes, two benefit approaches are used in the FASB pronouncements. The accumulated benefits approach bases pension expense (and liability) on current salary levels. The benefits/years-of-service approach makes its calculations on estimated future pay of the employees covered by the plan. In most cases, the benefits/years-of-service approach, upon which is based the projected benefit obligation, will be used to determine expense and the accrued pension liability (in the case of underfunding). For calculation of the possible minimum liability, the accumulated benefit obligation is used.

11. NONQUALIFIED PLANS

Qualified retirement plans provide many tax benefits not available in-nonqualified plans. The cost qualification and the prohibition against discriminatory benefits, however, motivate many employers to adopt nonqualified plans for selected, highly compensated employees. Nonqualified plans are ones that are not designed to satisfy the requirements of IRC Section 404(a). The following advantages are often cited for nonqualified plans:

- They are generally subject to less rigorous statutory regulation, thus making them easier and less costly to set up and maintain.
- Officers and other highly compensated or shareholding employees can be targeted for special benefits.
- Employees usually are not currently taxed on their employer's contributions to the plan.
- Employers take a deduction for their contributions at the time employees are taxed on the benefits.

Nonqualified plans should not be set up without professional advice. Despite an employer's intentional avoidance of ERISA rules, in rare cases, a nonqualified plan may trigger statutory requirements for participation, vesting, disclosure, and reporting.

11.1 Deferral of Compensation

Under certain conditions, nonqualified arrangements can assist employees by deferring taxability of part of their income from the year it is earned until a later year. To achieve this deferral, the arrangement must be structured so that the employee is not in actual or constructive receipt of the benefits nor does the employee enjoy any of the economic benefits of the arrangement until the later year. Treasury Regulations Section 1.451-2(a) provides the general rule on constructive receipt:

> Income, although not actually reduced to the taxpayer's possession, is constructively received by him in the taxable year during which it is credited to his account, set apart for him or otherwise made available so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Treasury Regulations Section 1.83 and, particularly, Revenue Ruling 60-31, 1960-1 CB 174 relate to the timing of taxation. The following is a simplified overview. An employee will be considered to have the economic benefit of property that has not actually or constructively been received, if interest in the property can be assigned to another person. Similarly, the employee has the economic benefit if the property is placed in a trust or escrow account on his or her behalf without its being subject to a substantial risk of forfeiture. A risk of forfeiture exists if the legal obligation to pay the employee is subject to a substantial contingency such as, for example, the future performance of substantial services by the employee (IRC Sec. 83 (a) and (b)).

Many nonqualified arrangements involve an unfunded and unsecured promise to pay in a later year. An arrangement of this type is referred to as a *pay-as-you-go plan,* or as *terminal funding.* In order for the employee to achieve tax deferral, the agreement to defer payment to the later year must be made before the payment is earned, and the employer's obligation to make payment must not be represented by a promissory note or secured in any way (Rev. Rul. 60-31, 1960-1 CB 174). An arrangement will be considered to be funded and the funds constructively received if funds are placed in a trust, custodial, or escrow account or are used to make payments toward an annuity contract, and the employee has a right to receive the payment directly from the trust, account, or annuity (or to transfer rights to another) even if the right will come about only at a future date.

If the funds for payment remain part of the assets of the company, however, they will be subject to claims from other creditors, and the employee is a general and unsecured creditor of the company. In such a situation there is sufficient risk of nonreceipt to bring about tax deferral.

The employer's obligation will be considered to be unfunded if the company is designated as the sole beneficiary of the trust, account, or annuity. Alternatively, even though payment may be secured by funds set aside in a trust, account, or annuity, the company's payment obligation could be made contingent on the employee's continued performance of services with the company during the period designated for tax deferral. Either technique fulfills the objective of tax deferral.

Under IRC Section 3121(v)(2), an amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of Social Security when the services are performed. In other words, if an employee did not reach the Social Security maximum and amounts were deferred under a deferred compensation agreement, the deferred amounts would be subject to Social Security tax at the time they are deferred. If the employee exceeded the Social Security maximum at the time of the deferral, the compensation would not be subjected to Social Security tax. Because of the above, deferred compensation payments are not subject to Social Security tax when actual payment is made. These payments are normally reported on a Form W-2P, rather than on a Form W-2.

11.2 Department of Labor Considerations

It is crucial to be aware that nonqualified deferred compensation plans—even those that an employer may intend to be unfunded—are likely to fall under ERISA's requirements for participation, vesting, and funding, unless the plan is both (1) unfunded and (2) maintained by the employer "primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." Therein lies the particular attraction to start-up companies of non-qualified and unfunded plans. If they are unfunded and also carefully targeted to the select group of management or highly compensated employees—exactly the group likely to be seen as most critical to motivate and reward—many of the complexities of ERISA can be avoided.

Unfunded plans maintained primarily to provide deferred compensation for a select group of management or highly compensated employees are exempt from participation, vesting, funding, and fiduciary responsibility provisions of ERISA. Little guidance is provided in determining what will constitute this select group.

Labor Department Regulations Section 2520.104-23 provides an alternative form of compliance with the reporting and disclosure requirement of ERISA for plans targeted for a select group of management or highly compensated employees. The reporting and disclosure provisions will be satisfied by filing a statement with the secretary of labor that includes the following:

- Name and address of the employer
- Employer identification number
- A declaration that the employer maintains a plan or plans primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees
- A statement of the number of such plans and the number of employees in each plan
- Plan documents, if any, upon request by the secretary

If the alternative method is not used, other reporting requirements would apply, including the requirements to file certain annual reports and to provide a summary plan description.

11.3 Securing Deferred Compensation

To provide assurance to employees that their deferred compensation will be paid, an employer may fund the promise of future payments. This security arrangement may unintentionally invoke taxation under the doctrine of constructive receipt. Private letter rulings released by the IRS have approved an approach that can avoid this problem by creating a trust, the assets of which are subject to the claims of the employer's creditors but are not currently accessible to the employee (see Private Letter Rulings 8113107 and 8329070). Additionally, the working premise of the Department of Labor seems to be that trusts of this nature will be treated as unfunded plans.

11.4 Taxation of Nonqualified Arrangements

Regardless of the employer's status as an accrual- or cash-basis taxpayer, the employer's contributions to a trust created under a nonqualified plan cannot be deducted until the employer's tax year, which ends in the same tax year the participants report the payments as gross income on their tax returns. (IRC Sec. 404(a)(5) and Treas. Regs. Sec. 1.404 (b)-1). Recipients include the payments as gross income in the year in which the benefits become either vested or transferable or are no longer subject to a substantial risk of forfeiture (see section 11.1 of this chapter). No deduction by the employer will be allowed if separate accounts are not maintained for each covered employee (IRC Sec. 404(a)(5)).

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SOCIAL SECURITY

SOCIAL SECURITY

1. BACKGROUND

1.1 History

With the enactment of the Old Age and Survivors Insurance program in 1935, the United States established the concept of a government-sponsored pension plan in this country. The revenue collected by this program was placed in a trust fund designed to insure workers in the areas of commerce and industry—with the exception of railroad employees, who were guaranteed benefits under the Railroad Retirement Act. In the 1950s coverage was expanded to include almost all workers in the United States, Puerto Rico, and the Virgin Islands. Americans working for U.S. employers outside the United States were also given coverage. By the end of the 1950s the program, renamed Old-Age, Survivors, and Disability Insurance (OASDI) and commonly referred to as Social Security, covered almost 90 percent of the American working population. During this period the self-employed and professionals gained coverage.

The Medicare program (a health insurance program for covered workers over age sixty-five and their spouses over sixty-five, and later for disabled workers covered by Social Security) was added to the Social Security structure in 1965. In 1972 the Supplemental Security Income (SSI) program was created to ensure a minimum level of income for the eligible elderly or disabled. SSI is funded out of general revenue.

Today, nine out of every ten workers in the United States are earning protection under the Social Security system and one of every six Americans receives monthly checks. By withholding FICA (Federal Insurance Contributions Act) taxes, employers and self-employed persons ensure that the system has sufficient funds to provide retirement benefits for those who qualify. In addition, Medicare currently covers almost the entire U.S. population over age sixty-five and three million disabled under that age.

1.2 Purpose and Goals

The Social Security program is designed to assure that Americans receive a continuing source of income when their income is reduced by the retirement, disablement, or death of an insured worker. Social Security is not intended to replace all lost earnings but rather to supplement savings, pensions, investments, or other insurance plans.

1.3 When to Contact Social Security

In order to receive Social Security benefits, it is necessary to apply for them. Recommended times to contact Social Security include

— When a person is unable to work because of an illness or injury that is expected to last a year or longer.

— When a person sixty-two or older plans to retire.

— When a person is within three months of age sixty-five even if he or she doesn't plan to retire.

— If a family member who has worked and contributed to Social Security dies.

— If a worker, spouse, or dependent child suffers permanent kidney failure.

In most instances, dealings with the Social Security Administration can be conducted by telephone. The telephone number for the nearest Social Security office can be found in the telephone directory under "Social Security Administration" or "U.S. Government." Because of the heavy volume of telephone calls received at the Social Security offices during the first week of each month, it is strongly recommended that non-urgent calls be made after the middle of the month. Persons calling Social Security should have available their Social Security and Medicare cards. Callers having questions regarding their Social Security or SSI checks should have the claim number appearing on their check readily accessible. (See section 6, herein.)

2. RETIREMENT BENEFITS

2.1 Qualification

For a worker, or a spouse or child of a worker (and in some select cases a dependent parent of a worker) to be eligible for benefits certain minimum requirements must be met.

2.1.1 Work credits needed

To receive retirement benefits, a worker must have accumulated a required amount of work credits. Work credit is measured by "quarters of coverage," with four quarters of coverage equaling one year of coverage.

Presently an employee or self-employed person receives one quarter of coverage for each $500 earned annually doing work covered by Social Security or in net earnings from self-employment. The maximum number of credits that can be earned per year is four. The dollar amount required to earn a quarter of coverage increases periodically to keep pace with average wages. The exact amount of credits required for retirement benefits depends on the age of the covered person. Under Social Security, a person who stops working and accumulating enough credits to be eligible for benefits cannot receive individual or family benefits (coverage is either all or nothing). Work credits are, however, recorded on a person's Social Security record and if a person returns to work, under Social Security, his or her previous credits will be counted toward determining eligibility for benefits.

The following table shows work credits needed for retirement benefits.

If you reach age sixty-two in	Work credits you need	Years you need
1983	32	8
1984	33	8¼
1985	34	8½
1986	35	8¾
1987	36	9
1988	37	9¼
1989	38	9½
1990	39	9¾
1991 or later	40	10

Work credits required for employees of nonprofit organizations or for disabled persons may vary from the preceding standards (see sections 3.1 and 4.2, below).

2.1.2 Work performed outside the United States

The 1983 Social Security Amendments allow any American employer to provide coverage for U.S. citizens and residents working for a foreign affiliate, provided that the U.S. employer has at least a 10 percent direct or indirect interest in the foreign-affiliate employer.

In addition, the President of the United States may enter into bilateral agreements with foreign countries stating that employees of either country are taxed only by their country of residence. Bilateral agreements (or totalization agreements) thus eliminate dual taxation for work performed in countries bound by the agreement. The United

States has entered into bilateral agreements with Sweden, Switzerland, Italy, West Germany, Norway, Belgium, Canada, Great Britain, France, and Spain.

2.1.3 Spouse and child requirements

If a worker covered by Social Security is receiving retirement or disability benefits, the following are also entitled to monthly benefits:

— All unmarried children under age eighteen (nineteen if full-time high school students)

— Any unmarried children eighteen or older who were severely disabled before the age of twenty-two and continue to be disabled

— A spouse age sixty-two or older

— A spouse under age sixty-two if the spouse is caring for a child under the age of sixteen who is getting a benefit based on the retired or disabled worker's earnings or is caring for the worker's disabled child

— Any divorced spouses age sixty-two or older, provided the marriage lasted ten years or longer and the divorced spouse has not remarried

Facts to consider:

— If an eligible divorced spouse has been divorced for two years or longer, he or she may receive benefits regardless of whether the former spouse is receiving benefits or not. The former spouse must, however, be eligible for benefits.

— A marriage must have lasted for at least one year before dependents of a retired worker can receive monthly benefits.

2.2 Rules Governing When to Apply for Benefits

Persons planning to retire before age sixty-five should apply for Social Security benefits no later than the last day of the month for which benefits are desired to begin. Generally, benefits for months of retirement before the age of sixty-five cannot begin before the person applies for the benefits (starting in 2000, the age at which full benefits are payable will be gradually raised to sixty-seven). Furthermore, benefits can only be paid for months during which the person has been eligible for the entire month.

For those applying for benefits after reaching age sixty-five, back payments can be made for up to six months prior to the month of application. To ensure that benefits start on time, it is permissible to apply up to three months before benefits are to start. For Medicare coverage to begin at age sixty-five, a person must enroll for coverage during this three-month period. When applying for benefits, make sure to have the following:

— Social Security card or a record of number

— Proof of age

— Proof of spouse's age

— Marriage certificate, if spouse is entitled to receive benefits

— Children's birth certificates, if children are entitled to benefits

— Form W-2 for the latest year of employment or a copy of your latest federal income tax return, plus copies of canceled checks for taxes paid if self-employed

2.3 Responsibility for Reporting

When a person receives the benefits of Social Security he or she assumes responsibility for reporting certain changes in facts to the Social Security Administration. If changes are not timely filed or if a false statement is made, the penalty can be a deduction from benefits, a fine, or imprisonment. Benefits can also be held back for future entitlements of family members.

2.3.1 What must be reported

The Social Security Administration requires that individuals who are receiving Social Security report

— Change of mailing address.

— Earnings of more than the annual limit.

— Travel outside the United States.

— Work outside the United States.

— Imprisonment for a felony.

— Spouse's receipt of a government pension.

— Marriage, divorce, or annulment.

— Adoption of a child.

— Child leaving the care of a parent.

— Child nearing eighteen who is disabled or a full-time student.

— Change in school attendance for a student eighteen to nineteen.
— Eligibility for or receipt of a pension from work not covered by Social Security.
— Inability to manage funds.
— Death of person receiving benefits.

2.3.2 How to file a report

Reports can be made to the Social Security Administration by telephone, by mail, or in person. The following information must be included:

— Name of person or persons about whom the report is being made
— Facts of report
— Date of facts
— Signature (if not filing by telephone)
— Address
— Claim number (the nine-digit Social Security number [000-00-0000] followed by a letter)

2.4 Work After Retirement and Social Security

To receive retirement benefits, a worker need not retire completely; however, wages and self-employment income earned after benefits begin may affect the amount paid in benefit checks. The SSA uses an earnings test to determine if benefits are to be reduced or stopped because earnings are above the annual limit. There is no limit to earnings for people seventy and older, and full benefits will be paid in 1989 if annual earnings do not exceed

— $6,480 for people under sixty-five.
— $8,880 for people sixty-five through sixty-nine.

If earnings exceed the annual limit, $1 will be deducted from benefits for every $2 of earnings (beginning in 1990 $1 of benefits will be withheld for every $3 of earnings above the annual limit). These reductions will also affect family members' benefits. But, if a person receiving benefits based on a worker's earnings has personal earnings from work exceeding the allowable limit, only that person's benefits will be reduced. Earnings must be counted for the entire year; for most people, this means January through December. Annual reports of earnings must be filed by April 15 of the following year, and reports of expected changes in earnings must be made to the SSA as soon as they are known.

2.4.1 The special monthly rule

The special monthly rule applies for people who wish to retire during a year and would like to receive benefits for the remainder of the year. This rule states that a person can receive full benefits for any month in that year in which the monthly exempt amount is not exceeded and substantial services are not performed in self-employment. Current exempt amounts are

— $540 for persons under sixty-five.

— $740 for persons sixty-five or older.

Substantial services are judged based on amount of time devoted to business, type of services rendered, and how services rendered compare to those performed in the past. Work totaling more than forty-five hours each month will generally be considered substantial. Work of fewer than fifteen hours in a month will not be considered substantial.

2.4.2 What counts as earnings

It is important to use the SSA definition of earnings when figuring earnings. For an employee, gross wages are counted, not just take-home pay. For the self-employed, net losses can be deducted. People who are both employees and self-employed must combine earnings. If wages earned during the year were paid after year-end they must still be counted as earnings for the year in which the work was done. In addition, the following are also counted as earnings:

— Bonuses, commissions, fees, vacation pay, and pay in lieu of vacation

— Cash tips amounting to $20 or more from work for one employer

— Severance pay

— Noncash payments such as meals or living quarters

— Fees collected as director of a corporation

— Deferred compensation

— Personal use of employer-provided vehicles

2.4.3 What does not count as earnings

Not all types of income are considered earnings by the SSA. The following is a list of income items not required to be counted as earnings:

— Investment income in the form of dividends from stocks (must be counted as income by securities dealers)

— Interest on savings accounts

— Income from Social Security benefits, pensions, other retirement pay, or Veterans Administration benefits

— Income from annuities

— Gain or loss from the sale of capital assets

— Gifts or inheritances

— Rental income from owned real estate (must be counted as income by real estate dealers and certain farm owners)

— Royalties received at or after age sixty-five from patents obtained before turning sixty-five

— Retirement income of a retired partner if

The retirement payments are to continue for life under a written agreement that provides for payments to all the partners (or to a class or classes of them)

An individual's share of the partnership capital was paid in full before the end of the partnership's taxable year and there is no obligation from the partnership to the individual except to make retirement payments

— Income from a limited partnership

— Income from self-employment that is not attributable to services performed after the month of entitlement

Special rules apply to payments from certain trust funds, payments from certain annuity plans, sick pay received after the sixth full calendar month after the employee last worked or paid after employment was terminated, loans from employers unless repaid by work, moving expenses, travel expenses, and pay for jury duty. (Additional information on these subjects can be obtained from local Social Security offices.)

Example. Computing reduction in SSA benefits: Joe Elder, 64, is single and receives monthly SSA benefit checks. During 1989, Joe received total SSA benefits of $8,000. Joe worked at his son's hardware store and received a W-2 for $5,000. He is also a director of City Bank, and received $1,500 in director fees for 1989. Joe's other income included $1,000 interest income and $500 rental income. The following is a computation of Joe's reduction in SSA benefits for 1989.

SSA earnings	
W-2 wages	$5,000
Director fees	1,500
Total	$6,500
SSA allowed earnings	(6,480)
	$ 20
	÷2
Reduction in benefits	$ 10

2.5 Calculations of Future Retirement Benefits

The Social Security Administration has always encouraged individuals to check their Social Security earnings records for accuracy. However, the information provided was limited to a breakout of annual earnings for the last four years and a summary of all earnings from 1937 to the present. They also provided, if requested, an indication of insured status and limited estimates of retirement benefits.

To overcome these limitations, the SSA has redesigned the system to provide workers a more complete statement of their earnings and benefit estimates. The new, enhanced statement, known as the Personal Earnings and Benefit Estimate Statement (PEBES), serves as a viable tool for workers to verify their posted earnings and to learn the estimated amount of FICA taxes paid on the earnings. It also explains what they may expect in the way of Social Security protection so as to aid in their planning for their own future financial security.

The revised statement is now available to the general public and can be requested by using the new request form SSA-7004. These forms can be obtained by writing: Consumer Information Center, Dept. 55, Social Security Administration, Pueblo, CO 81009.

Persons who complete the new request form are asked to provide information about their most recent earnings (which are not yet on record), their expected future earnings, and the age at which they plan to retire. This information is used in calculating the benefit estimates.

The new statement of earnings will provide workers with the following information:

— A summary of their earnings from 1937–1950

— An annual breakout of earnings from 1951-present, with the corresponding estimated FICA taxes.

— Benefit estimates for retirement at a reduced age, full retirement age, and age 70, and for survivors and disability benefits.

— More realistic estimates using the worker's anticipated future earnings and recent unposted earnings, as well as including projected real wage growth.

— The number of credits the worker needs to be insured for each type of benefit and the credits currently on record.

Note that the new statement will not be available to the following categories of individuals. Those who

— Have no Social-Security-covered earnings on record.

— Have only Medicare-qualified government earnings (MQGE) on record.

— Have 120 or more months of railroad service.

— Already receive Social Security benefits, who have a benefit claim pending, or who are age 65 or older.

Persons in any of the above categories will receive a modified statement that will not include all of the information described earlier.

Benefit amounts vary for people with differing average incomes, but a retired worker reaching age sixty-five in 1989 can receive as much as $899 per month without dependents.

2.6 Early Retirement

Although a person cannot receive full retirement benefits before reaching age sixty-five, it is possible to receive reduced benefits starting at age sixty-two. A covered worker retiring at sixty-two can receive 80 percent of the full benefit amount. Spouse's benefits starting at age sixty-two will be reduced to 75 percent of the full benefit amount. (These benefit reductions are permanent, to compensate for the extra time the checks will be received.) Each month a person waits to retire after turning sixty-two will increase the amount of benefit received until it is at 100 percent when he or she turns sixty-five.

2.6.1 Advantages of retiring before age sixty-five

Retirement before sixty-five means reduced monthly payments, but not necessarily less money in the long run. During the thirty-six-month period between age sixty-two and sixty-five a person will be receiving payments he or she would not ordinarily receive. Despite the fact that monthly payments are permanently reduced, it can take an average of twelve years beyond age sixty-five to offset the total amount of the additional thirty-six checks received. If a portion of the money received from Social Security is invested, the time required to offset the difference would be increased even further.

Example. If Mr. Williamson begins collecting a reduced benefit payment of $480 a month at sixty-two and Mr. Harrison (who is entitled to the same benefits) waits until age sixty-five to receive a benefit payment of $600 a month, Williamson will be receiving checks for three years before Harrison receives his first check. Thus, even if Williamson does not invest the money he received during the three additional years, it will take Harrison twelve years to receive benefit payments equal to the payments received by Williamson.

2.6.2 Advantages of working beyond age sixty-five

Benefits will be increased by 3 percent per year for each year a person continues to work beyond age sixty-five, through age sixty-nine. Beginning in 1990 this credit will be gradually increased until it reaches 8 percent by 2008.

Example. A person who is entitled to $500 monthly retirement benefit at sixty-five will be entitled to a $515 monthly retirement benefit if he or she waits until age sixty-six to retire.

2.7 Payment of Retirement Benefits to Recipients Outside the United States

Citizens of the United States or any of the countries listed here can receive their Social Security checks no matter how long they stay outside the United States, as long as they are eligible for the checks.

Antigua and Barbuda
Argentina
Austria
Bahamas
Barbados
Belgium
Belize
Bolivia
Bourkina Faso
Brazil
Canada
Chile
Colombia
Costa Rica
Cyprus
Czechoslovakia
Denmark
Dominica
Dominican Republic
Ecuador
El Salvador
Federated States of Micronesia
Finland
France
Gabon
Greece
Grenada
Guyana
Iceland
Ireland
Israel
Italy
Ivory Coast
Jamaica
Japan
Liechtenstein
Luxembourg
Malta
Marshall Islands
Mexico
Monaco
The Netherlands
Nicaragua
Norway
Panama
Peru
Philippines
Poland
Portugal
San Marino
Spain
St. Lucia
Sweden
Switzerland
Trinidad-Tobago
Trust Territories of the Pacific (Palau)
Turkey
United Kingdom
West Germany
Western Samoa
Yugoslavia
Zaire

(This list of countries is subject to change from time to time.)

If the recipient is not a citizen of the United States or one of the other countries listed above, the checks will normally stop six months after leaving the United States. For exceptions to this policy, contact a local Social Security office.

U.S. Treasury Department and Social Security regulations prohibit sending checks if the recipient is in Albania, Cuba, Democratic Kampuchea (formerly Cambodia), East Berlin, East Germany, North Korea, Vietnam, or the U.S.S.R. U.S. citizens can receive all the withheld checks once they leave these countries for a country where Social Security is able to send checks.

3. SURVIVORS' BENEFITS

3.1 Qualification

Social Security coverage does not necessarily stop with the death of an insured worker. Social Security survivors insurance can provide cash benefits on the earnings record of a deceased worker to

— A widow or widower—full benefits at 65 or any age if caring for an entitled child (under 16 or disabled) of the deceased worker. Reduced benefits can be received at 60 (or 50 and disabled) if not caring for a child. Remarriage after 60 (50 if disabled) will not prevent the payment of benefits provided the worker died before the remarriage.

— Unmarried children up to 18 (or 19 if they are attending an elementary or secondary school full time). Children who were disabled before 22 can receive benefits at any age as long as they remain disabled.

— Divorced widow or widower after 10 years of marriage—full benefits at 65 or any age if caring for an entitled child (under 16 or disabled) of the deceased worker. Reduced benefits can be received at 60 (or 50 if disabled). Remarriage after 60 (or 50 if disabled) will not prevent the payment of benefits.

— Divorced widow or widower married less than 10 years—at any age if caring for an entitled child (under 16 or disabled) of the deceased worker.

— Lump-sum death payment—is a one-time payment of $255. This is in addition to any monthly survivor insurance benefits. It is paid to the surviving widow(er) who was either living in the same household as the deceased at the time of death or was eligible for or entitled to survivor's benefits on the deceased worker's record for the month of death. If there was no surviving widow(er), it is payable to a child or children eligible for or entitled to survivors' benefits on the deceased worker's record for the month the worker died.

In addition, grandchildren, great-grandchildren, and dependent parents 62 or older may qualify for survivors' benefits on the deceased worker's record under certain circumstances.

In order for eligible surviving relatives to receive monthly checks following a covered worker's death, the worker must have met certain minimum work credit requirements during his or her lifetime (see section 2.1, above). Under a special provision, payments can be made to a worker's children and the worker's mother or father provided that the worker worked under Social Security for a period of a year and a half during the three years preceding his or her death. The following table represents the number of work credits required for persons born before 1930.

Born before 1930, die in	Credits needed	Years you need
1985	34	8½
1986	35	8¾
1987	36	9
1988	37	9¼
1989	38	9½
1990	39	9¾
1991 or later	40	10

For persons born after 1929, the following table applies.

Born after 1929, die at age	Credits needed	Years you need
28 or younger	6	1½
30	8	2
32	10	2½
34	12	3
36	14	3½
38	16	4
40	18	4½
42	20	5
44	22	5½
46	24	6
48	26	6½
50	28	7
52	30	7½
54	32	8
56	34	8½
58	36	9
60	38	9½
62 or older	40	10

3.2 Benefits

The amount of monthly benefit checks varies depending on the worker's average earnings, but a widowed mother with two children can receive an average of $1,112 per month.

4. DISABILITY BENEFITS

4.1 Definitions

4.1.1 Social Security definition of disability

In determining a person's eligibility for disability benefits, it is important to be aware of what Social Security considers disabling. To be considered disabled under Social Security law a person must have a physical or mental condition that

— Prevents the person from doing any "substantial gainful work" (see section 4.1.2, below).

— Is expected to last (or has lasted) for at least twelve months or is expected to result in death.

To prove disability, the SSA must be supplied with medical evidence from physicians or other sources showing the extent of the person's condition and the degree to which it prevents that person from working. Social Security Regulations contain a complete list of conditions that are considered disabling. Circumstances the SSA usually considers disabling include

— Diseases of the heart, lung, or blood vessels that have resulted in serious loss of heart or lung reserves as shown by x-ray, electrocardiogram, or other tests and, in spite of medical treatment, there is breathlessness, pain, or fatigue.

— Severe arthritis that causes recurrent inflammation, pain, swelling, and deformity in major joints so that the ability to get about or use the hands is severely limited.

— Mental illness resulting in marked constriction of activities and interests, deterioration in personal habits or work-related situations, and seriously impaired ability to get along with other people.

— Damage to the brain or brain abnormality that has resulted in severe loss of judgment, intellect, orientation, or memory.

— Cancer that is progressive and has not been controlled or cured.

— Diseases of the digestive system that result in severe malnutrition, weakness, and anemia.

— Progressive diseases that have resulted in the loss of a leg or have caused it to become useless.

— Loss of major function of both arms, both legs, or a leg and an arm.

— Serious loss of function of the kidneys.

— Total inability to speak.

A similar definition of disability applies to disabled surviving spouses and disabled children.

4.1.2 Social Security definition of substantial gainful work

In determining eligibility for disability benefits, substantial gainful work or substantial gainful activity is defined differently for employees and for the self-employed. For employees, the amount of earnings is the primary factor. The general rule is that average earnings of $300 a month (after allowable deductions) imply substantial gainful work. Average earnings of between $190 and $300 per month can be considered gainful if other workers in the same area are receiving comparable earnings. This decision is also based on the time, energy, skill, and responsibility involved in the work. The work need not be in the worker's previous field, but people who can do other substantial work may not be considered disabled. Earnings of less than $190 a month are not considered gainful. For self-employed persons, "substantial work" is based on the type and value of the work performed (including management).

Certain impairment-related expenses for items or services needed to work can be deducted from earnings when deciding if work is substantial and gainful. These expenses can be deducted only if the worker keeps records of them and provides proof of payment for all expenses.

For workers disabled by blindness, these rules apply:

— Average monthly earnings of $740 or less in 1989 are not considered substantial and gainful.

— If the worker is fifty-five to sixty-five, monthly benefits will continue if the worker cannot resume doing the same or similar work he or she did before becoming blind or turning fifty-five, whichever is later.

4.2 Qualification

In addition to being considered disabled by the SSA, a worker must have accumulated enough work credits to be entitled to receive benefits. A person disabled before age twenty-four needs one and one-half years of covered work in the three-year period ending when the disability began. For a worker aged twenty-four through thirty-one, credit is required for working half of the time between turning twenty-one and becoming disabled. For disabled workers thirty-one or older, the general rule is that they must have earned at least five years of work credit in the ten years immediately before they became disabled. An exception to this rule is people disabled by blindness who may have earned credit at any time after 1936; for them no recent work is required.

For workers age thirty-one or older, this table applies.

Born after 1929, became disabled at	Born before 1930, became disabled before sixty-two in	Years of work credit you need
31–42		5
44		5½
46		6
48		6½
50		7
52	1981	7½
53	1982	7¾
54	1983	8
55	1984	8¼
56	1985	8½
57	1986	8¾
58	1987	9
60	1989	9½
62 or older	1991 or later	10

4.3 Who Can Receive Disability Benefits

In many cases Social Security benefits can be received by family members of disabled workers as well as by the workers themselves (the following list of eligible family recipients applies only with respect to disabled workers who have been approved for disability benefits):

— Unmarried children (including stepchildren, adopted children, and in some cases, grandchildren or great-grandchildren) who are under eighteen (nineteen if in high school full-time) or if over eighteen, disabled before age twenty-two

— A spouse caring for a worker's child who is under sixteen or disabled and also receiving checks

— A spouse age sixty-two or older

— Disabled widows and widowers (and in some cases disabled surviving divorced spouses) of workers who were insured at death (These checks are payable as early as age fifty.)

4.4 Applying for Disability Benefits

4.4.1 How to apply

It is necessary to apply for disability benefits to receive them. An application for disability benefits should be filed as soon as a condition appears likely to prevent all substantial gainful work for at least a year. If an applicant is unable to go to a Social Security office to apply in person, other arrangements can be made by phone. A spouse, parent, other relative, friend, or legal guardian may also complete the application. When applying be sure to have the following data available:

— The Social Security number and proof of age for each person eligible for payments

— Names, addresses, and phone numbers of doctors, hospitals, clinics, and institutions where treatment has been received, with dates of treatment and hospital or clinic numbers if known

— An employment history covering the past fifteen years

— A copy of W-2 forms (wage and tax statements), or federal tax returns for self-employed people, for the past year

— Dates of any military service

— Dates of any prior marriages if a spouse is applying for benefits

— The claim number of any other benefit check received or expected to be received because of the disability

— The worker's death certificate and proof of marriage if the person applying for checks is a disabled widow or widower

— Information about any worker's compensation claims

To ensure that applications are processed as quickly as possible, information must be complete and accurate. Additional evidence or information requested by the SSA should be furnished promptly.

4.4.2 Additional facts to consider

Social Security checks paid to a child will stop at age eighteen. If disability occurs, Social Security should be contacted several months before the person's eighteenth birthday to ensure that benefit checks will continue, based on the disability. Checks are available to a disabled widow or widower between ages fifty and sixty if the disability started before the spouse's death or within seven years afterward. If checks were received by a widow or widower with children, eligibility begins at age fifty or older if the person becomes disabled before the payments end or within seven years after they end. The marriage must have lasted ten years or longer in the case of a surviving divorced wife or husband; proof of this will be necessary when applying.

4.5 The Disability Decision

When a person meets all the basic requirements, the Social Security office sends the claim to the Disability Determination Services (DDS) office in the applicant's state of residence. The DDS employs physicians and disability-evaluation specialists to determine if people are disabled under Social Security law. The DDS will obtain all medical records needed to make a determination and may request that the person in question have a special examination paid for by Social Security. The process usually takes two or three months, after which time a written decision will be mailed.

4.5.1 If the claim is approved

If the claim is approved, the applicant will receive a certificate of award and will be told when the checks will begin and the amount of the benefit. Typically, monthly checks begin in the sixth full month of an SSA-recognized disability. The amount of the benefit check is dependent on the worker's average earnings covered by Social Security. Current payments average $529 monthly to an individual worker and $943 to a worker with a family.

4.5.2 Right to appeal if claim is denied

If the SSA denies a disability claim, the person filing the claim will receive written notification explaining the denial. The complainant then has sixty days to file a written appeal with any Social Security office. Appeals are initially reconsidered by the DDS. If again denied, the complainant can request a hearing before an administrative law judge, then a review by the appeals council, and then civil action in a federal court (in that order).

4.6 Items That Can Affect Disability Benefits

The following occurrences can lead to changes in benefit amounts and must be reported to the Social Security Administration:

— Death

— Change of address

— Any changes in disabling condition
— Return to work (see section 4.7, below)
— Travel outside the United States
— Other disability checks received
— Pension from work not covered by Social Security
— Government pension received by spouse or surviving spouse
— Marriage
— Inability to manage own funds
— Conviction of a felony

The reporting procedure is the same described in section 2.3.2.

4.7 If a Disabled Person Works

Social Security is not designed to discourage disabled persons from returning to work and, therefore, benefits do not stop as soon as one returns to work. Most people receiving checks are entitled to a trial work period during which they can continue receiving benefits for up to nine months while testing their ability to work (the worker must still be disabled). Usually only months in which a person earns more than $75 in gross wages count as trial months. Trial months for self-employed people are based on $75 net earnings and more than fifteen hours devoted to the business. The nine months do not have to be consecutive. At the end of the trial period, a decision is made as to whether the person can do substantial gainful work (see section 4.8 below). If it is determined that the worker can do the work, benefits continue for an additional three months (the month in which disability ends plus the two following months) and then stop. If the worker is still judged disabled, the benefits continue until the condition changes. If the worker's disability ceases during the trial period, the benefits will continue for three months and then stop.

There is an extended period of eligibility of 36 months after the trial work period during which a person may receive benefits for any month during which he or she does not perform substantial gainful activity. If disability payments stop because of work activity and a person is still disabled, Medicare can continue for up to 24 months after the extended period of eligibility. Just about everybody who receives Social Security disability benefits is referred to a State Vocational Rehabilitation Agency for possible vocational rehabilitation services. If a person unexpectedly recovers while under an approved vocational rehabilitation program likely to enable him or her to work, payments may continue until the plan is completed. In addition, certain impairment-related work expenses that a disabled person needs in order to work may be deducted when counting earnings to determine if the person is performing substantial gainful activity for SSI purposes. Examples include medical devices such as a wheelchair or braces, attendant care services, transportation costs, and work-related equipment such as a special typewriter or braille device.

4.8 Disability Review Process

To ensure that all persons receiving disability benefits are actually still disabled, the SSA requires periodic reviews of all cases. Notice letters are mailed to any person whose case is up for review and that person is requested to visit the closest Social Security office (unless the impairment prevents the person from going to the office). An SSA agent reviews all information, including any new information relevant to the case, then sends the updated folder to DDS. A team composed of a doctor and a disability examiner will then review the case and make a determination. If more medical evidence is needed, an additional examination paid for by the SSA may be required. All decisions are based on a uniform national policy.

Reviews are scheduled based on the following conditions:

— Improvement expected: First review six to eighteen months after disability decision is made

— Improvement possible: Once every three years

— Improvement not expected: Once every five to seven years

If the worker's condition is determined to be no longer disabling, benefit payments will be stopped after three months. A worker who disagrees with a decision can file an appeal within sixty days. If an appeal is filed during the first ten days of the sixty-day period, benefits can continue through the appeal process. If the appeal is denied, payments will stop after three months (and payments received during the appeal process must be returned, unless a waiver of overpayment is requested and granted).

4.9 If a Worker Becomes Disabled Again

If a worker who has received disability checks becomes disabled for a second time within five years after payments have stopped (for any reason), the new checks can start with the first full month of the new disability; the five-month waiting period is not required. This provision also applies to disabled widows or widowers and persons disabled before age twenty-two who become disabled again within seven years after the earlier benefits end.

5. MEDICARE

5.1 Description

Medicare is a federal health insurance program for people sixty-five or older, people of any age with permanent kidney failure, or people with certain other disabilities. Medicare is administered by the Health Care Financing Administration (HCFA) and covers people receiving medical or hospital care anywhere in the United States (including the District of Columbia, Puerto Rico, the Virgin Islands, Guam, and American Samoa). Medicare is divided into two parts: hospital insurance and medical insurance. Hospital insurance helps pay for in-patient hospital care and certain outpatient follow-up care and is financed by part of the Social Security tax. Medical insurance helps pay for doctors' services and other medical services and is financed by the monthly premiums paid by people enrolled in the program (see section 5.4.1, below) and by general federal revenues.

5.2 Eligibility

To be eligible for Medicare hospital coverage, people age sixty-five or older must meet at least one of the following criteria:

- They are entitled to monthly Social Security or railroad retirement benefits.
- They have worked long enough to be insured under Social Security or the railroad retirement system.
- They have worked long enough in federal employment (see the table at the end of this section) to be insured for Medicare purposes.

People are entitled to coverage before sixty-five if they meet one of the following conditions:

- They have been entitled to Social Security disability benefits for twenty-four months.
- They have worked long enough in federal employment and meet the requirements of the Social Security disability program.

People are eligible at any age if they need maintenance dialysis or a kidney transplant for permanent kidney failure and

— Are insured or getting monthly benefits under Social Security or the railroad retirement system.

— Have worked long enough in federal employment.

Spouses and children of workers may also be eligible for maintenance dialysis or kidney transplant. Under certain conditions spouses, divorced spouses, widows, widowers, or dependent parents may be eligible at age sixty-five. This may also apply to disabled widows or widowers under sixty-five, disabled surviving divorced spouses under sixty-five, and disabled children eighteen or older.

Work credits needed for federal employees

If you reach age 65	Years you need
1983	7¼
1984	7½
1986	8
1990	9
1994 or later	10

5.3 Medicare Hospital Insurance (Part A)

5.3.1 How to get hospital insurance coverage

People receiving Social Security or railroad retirement checks do not have to apply for hospital insurance; it will begin automatically at age sixty-five (except for federal employees, who should apply three months before their sixty-fifth birthday). People who plan to keep working after age sixty-five should also file an application three months prior to turning sixty-five. Those not eligible for coverage at sixty-five because they do not have enough work credits or are not receiving benefits can purchase it for $158 a month in 1989 (to buy hospital insurance one must also buy medical insurance). People with permanent kidney failure should apply for Medicare as soon as the condition appears. There is a twenty-four-month waiting period for disabled workers under sixty-five and a two-month waiting period for people receiving maintenance dialysis treatment.

5.3.2 Hospital coverage

Hospital coverage provides benefits for inpatient care, skilled-nursing-facility care, home health care, and hospice care. If a person needs inpatient hospital care, Medicare Hospital Insurance provides year-round coverage for all medically necessary inpatient hospital care. Medicare hospital patients are required to pay a single deductible for their first admission in each calendar year. After this deductible (which can be paid out-of-pocket or through a private supplemental insurance plan) Medicare will pay all covered costs for the remainder of the calendar year regardless of the number of admissions or the number of days of medically necessary care. Coverage includes

— Semiprivate room and board.

— General nursing service.

— Lab tests, x-rays, other radiology services, and radiation therapy.

— Drugs furnished by the hospital.

— Medical supplies.

— Rehabilitation services.

— Cost of special-care units.

For patients requiring home health services, Medicare coverage includes

— Part-time skilled nursing care.

— Physical and speech therapy.

— Medical supplies and services provided by an agency.

— Occupational therapy.

Skilled-nursing-facility care and hospice care are also available to patients whose conditions require these services.

5.3.3 Patients' financial obligations

Medicare hospital insurance provides coverage for up to 150 days of medically necessary skilled-nursing-facility care each year. It is *not* necessary for the patient to have had a previous hospital stay, but the Medicare patient's doctor does have to certify the medical necessity for skilled-nursing-facility care.

The patient is required to pay (either out of pocket or through a supplemental insurance plan) coinsurance for the first eight days of skilled-nursing-facility services each calendar year. The coinsurance is 20 percent of Medicare's national average daily payment rate for skilled-nursing-facility care.

Medicare pays all costs for home health care and all costs for hospice care except for a 5 percent co-payment for drugs, biologicals (serum, vaccines, etc.), and respite care.

5.4 Medical Insurance (Part B)

5.4.1 How to get medical insurance coverage

People eligible for hospital insurance will automatically be enrolled for medical insurance unless they specifically refuse it at the time they become eligible for hospital insurance. The monthly premium for 1989 is $31.90 per month. People who must apply for medical insurance include

— People planning to work past age sixty-five.

— People age sixty-five who are not eligible for hospital insurance.

— People with permanent kidney failure.

— People eligible for Medicare on the basis of federal employment.

5.4.2 Medical coverage

Medical insurance coverage provides for doctors' services and outpatient care and includes

— Medical and surgical treatment.

— Services of a doctor's nurse.

— Drugs and biologicals that cannot be self-administered.

— Medical supplies and equipment (does not include basic first-aid equipment).

— Medically required ambulance services.

— Blood transfusions provided on an outpatient basis.

5.4.3 Patients' financial obligations

Medicare's part B coverage is designed to cover 80 percent of reasonable charges less the annual deductible ($75 in 1989). It should be noted, however, that if there is a difference between what the doctor charges and what Medicare considers reasonable, the patient must pay the difference.

5.5 What Medicare Does Not Cover

Services and supplies not covered by either hospital insurance or medical insurance include

— Custodial care such as help with bathing, eating, and taking medicine.

— Dentures and routine dental care.

— Eyeglasses, hearing aids, and examinations to prescribe or fit them.
— Personal-comfort items such as a phone or TV in a hospital room.
— Prescription drugs and patent medicines.
— Routine physical checkups and related tests.

5.6 Filing a Medicare Appeal

Decisions on the amount Medicare will pay on a claim or whether services received are covered by Medicare, may be appealed.

The notices sent from Medicare telling of the decision made on a claim will also tell exactly what appeal steps can be taken. Claimants have at least 60 days from the date they receive the notice in which to file their appeals. For more information about appeal rights claimants should call any Social Security office, the Medicare intermediary or carrier, or the peer review organization (PRO) in their states. Following is a brief summary of the different Medicare appeals processes.

5.6.1 Appealing decisions by peer review organizations

Peer review organizations are groups of doctors in each state who are paid by the federal government to help Medicare decide when hospital care is necessary and meets standards of quality accepted by the medical profession. Medicare-participating hospitals can provide a brochure, "An Important Message From Medicare," which describes a hospital patient's appeal rights and supplies the name, address, and phone number of the PRO in that state.

If claimants disagree with the decision of a PRO, they can appeal by requesting a reconsideration. Then, if they disagree with the PRO's reconsideration decision and the amount in question is $200 or more, claimants can request a hearing by an Administrative Law Judge.

Cases involving $2,000 or more can eventually be appealed to a Federal Court.

5.6.2 Appealing all other hospital insurance (Part A) decisions

Appeals of decisions on all other services covered under Medicare hospital insurance (skilled-nursing-facility care, home health care, and hospice services) are handled by Medicare intermediaries. If claimants disagree with the intermediary's initial decision, they may request a reconsideration. The request can be submitted directly to the intermediary or through the claimant's Social Security office. If there is further disagreement with the intermediary's reconsideration decision and the amount in question is $100 or more, the claimant can request a hearing by an Administrative Law Judge. Cases involving $1,000 or more can eventually be appealed to a Federal Court.

5.6.3 Appealing decisions on medical insurance (Part B) claims

Under Medicare medical insurance, either the claimants, their doctors or their suppliers submit the claim for payment. Medicare will send the claimant an explanation of the decision of the claim on a form called "An Explanation of Medicare Benefits" (EOMB). The EOMB also explains how the claimant can appeal denials or payment decisions with which he or she disagrees, and gives the name, address, and statewide toll-free number of the carrier (the names and addresses of the carriers and areas they serve are also listed in the back of *Your Medicare Handbook*).

If a claimant disagrees with the decision on the claim, he or she can ask the carrier to review it. Claimants have up to six months from the date on the EOMB to request the review and the request must be sent to the carrier in writing.

If there is further disagreement with the carrier's written explanation of its review decision and the amount in question is $100 or more, the claimant can request a hearing by the carrier. (Other claims that have been reviewed within the previous six months can be counted towards the $100 amount.)

If there is disagreement with the carrier hearing decision and the amount in question is $500 or more, claimants are entitled to a hearing before an Administrative Law Judge. Cases involving $1,000 or more can eventually be appealed to a Federal Court.

5.6.4 Appealing decisions by health maintenance organizations and competitive medical plans

If the claimant is a member of a Medicare-certified health maintenance organization (HMO) or competitive medical plan (CMP), the same appeal rights that all other Medicare beneficiaries have apply. However, the initial steps of the grievance or appeals procedure may vary from plan to plan. Federal law requires Medicare-certified HMOs and CMPs to provide a full, written explanation of appeal rights to all members at the time of enrollment. If claimants are members of such a plan and have not received a written explanation of appeal rights, they should request one from their plan's membership office or write to: Health

Care Financing Administration, Office of Prepaid Health Care, Humphrey Bldg., 200 Independence Ave. S.W., Washington, D.C. 20201.

5.7 Supplemental Health Insurance

Medicare does not discourage people from buying additional health insurance, but they should avoid plans that simply duplicate Medicare's coverage. For protection, people wishing to cancel existing policies in favor of Medicare should not cancel any health insurance they have until the month Medicare begins. For people working past age sixty-five who have employer health plans, Medicare will be the secondary insurance payer (Medicare will pay for coverage not offered by employer health plans).

5.8 Medicare Catastrophic Coverage Act of 1988

The Medicare Catastrophic Coverage Act (MCCA) of 1988 was signed into law in July 1988. The act is designed to shield elderly citizens from the financial burden of major illness and limit the amount that must be paid for hospitalization and physician expenses.

5.8.1 Cost of catastrophic coverage

The MCCA of 1988 is designed to be self-supporting through two revenue-raising steps. First, starting in 1989, Medicare beneficiaries will be charged a 15 percent supplemental premium of their federal tax. This supplemental premium increases to 25 percent in 1990, 26 percent in 1991, 40.5 percent in 1992, and falls to 28 percent in 1993.

The supplemental premium is subject to minimum and maximum taxable income levels. No supplemental premium is required if taxable income is less than $1,000 on joint and single returns. The maximum supplemental premium per beneficiary through 1993 is as follows:

1989	$800
1990	850
1991	900
1992	950
1993	1,050

For married taxpayers who are both over 65, the maximum doubles.

Example. In 1989, Emil and Mildred Hanes, filing married jointly, had adjusted gross income of $25,000. Both Emil and Mildred are 67 years old. The couple does not itemize deductions, but uses the standard deduction. The supplemental premium would be computed as follows:

Adjusted gross income	$25,000
Standard deduction	(5,000)
Additional standard deduction ($600 × 2)	(1,200)
Personal exemptions	(4,000)
Taxable income	$14,800
Tax (using 1988 rates)	2,220
Supplemental premium	333
Total tax	$2,553

The second revenue-raising step is known as the basic premium. The MCCA of 1988 will increase Medicare Part B premiums in 1989 by $4 and in 1993 by $10.20. This increase is in addition to any inflation adjustment.

5.8.2 Benefits of catastrophic coverage

The MCCA of 1988 provides coverage similar to that provided by supplementary insurance companies to senior citizens. The law is designed to reduce the need for supplementary insurance and to provide through the SSA similar insurance at more reasonable rates. The law prohibits insurance companies from offering coverage that overlaps with federal benefits.

6. SUPPLEMENTAL SECURITY INCOME

6.1 Overview

In addition to retirement, disability, survivors', and medical benefits, Social Security also offers Supplemental Security Income (SSI) to assure a minimum monthly income to people with limited income and resources who are sixty-five or older, blind, or disabled. SSI is financed from general funds of the federal Treasury, not from Social Security taxes. Eligibility for the program is based on income and assets. A single person can own as much as $2,000 in resources and still receive checks (see section 6.2.3 for the SSI definition of resources); for a couple this figure is $3,000. Federal payments of up to $368 a month for individuals and $553 a month for couples are possible. Amounts of monthly checks vary because the amount is based on where a person lives (some states may add to the federal SSI payments), income, and living arrangements. Thus, first and second checks are based on a person's first month's income and living arrangements. The checks for the months that follow are based on income and living arrangements that existed for the two previous months (therefore, if no changes are reported, the amount of the check will not change). SSI cases are reviewed periodically to ensure that those receiving benefits are still eligible for them.

6.2 Responsibility for Reporting

Those who receive SSI are responsible for reporting changes in their conditions that could affect the amount of their checks within ten days after the end of the month in which the change occurred. Fines of up to $100 are imposed for failing to report changes or making false statements. Reports can be made by phone, by mail, or in person.

6.2.1 What must be reported

The SSA requires that a report be filed if a person meets any of these criteria:

— Moves or changes address

— Has a change in his or her household

— Has a change in income

— Has a change in resources

— Receives help with living expenses

— Enters or leaves an institution

— Leaves the United States

— Marries or ends a marriage

— Becomes a sponsored immigrant

— Condition improves while receiving benefits based on disability or blindness

— Starts or stops attending school

— Is a drug addict or alcoholic and stops treatment

The fact that a person receiving benefits cannot manage money or dies must also be reported. Some states also have additional reporting responsibilities.

6.2.2 State requirements

The following states have additional SSI reporting requirements:

California. Residents must report if they were eating meals away from home regularly and are now eating at home, and vice versa.

Hawaii, Michigan, Vermont. Residents must report if they are living in a facility that provides different levels of care and their level of care changes.

Massachusetts. Residents must report if they (or they and their spouses) were paying more than two thirds of the living expenses for the household and are now paying less, and vice versa.

New York. Residents have the same reporting requirements as do residents of California and must in addition report if they are living with other people and they formerly prepared their meals alone but are now preparing them with other people, and vice versa.

6.2.3 Social Security definition of resources

In order to determine if a person meets the SSI resource requirement to receive benefits one must know what SSI considers resources. A person's home and the land it is built on do not count. Household goods, personal property, and cars may not count, depending on their worth. In addition, up to $1,500 in burial funds for each worker and a spouse may not count. The following items *do* count as resources:

— Checking and savings accounts

— Certificates of deposit

— Stocks and bonds

— Money set aside for any purpose

6.2.4 What is not considered income by SSI

Items not counted as income by SSI include these:

— Medical care and services

— Social services

— Gain from sale, exchange, or replacement of personal property*

— Income tax refunds*

— Proceeds of a loan*

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*May become resources

6.3 Right to Appeal

As with any decision made by Social Security, everyone has the right to appeal a decision made concerning an SSI judgment. There are three ways to present a case for reconsideration.

Case review. Evidence in a file is reviewed by someone in the Social Security office who did not have a part in the decision being appealed. The person filing the appeal is not present during the review but may examine the evidence in the file before the review. To view medical records, a person must first appoint a representative. The person appealing can add any evidence that he or she feels will help the case.

Informal conference. An informal conference is similar to a case review except that the person filing the appeal may personally present reasons for disagreeing with a decision to the person who is making the reconsideration decision. Witnesses may also be produced.

Formal conference. A formal conference differs from an informal conference only in that unwilling witnesses will be requested to appear for cross-examination with any evidence about the case.

A case review can be requested if an applicant was turned down for SSI or if a recipient feels that the amount of his or her check is too small. Any of the three methods can be requested if SSI checks are terminated or reduced. The DDS uses the case-review method to deal with medical issues.

7. CONTRIBUTION RESPONSIBILITIES

7.1 Employers and Employees

Employers and employees pay an equal share of Social Security taxes. Employee taxes are deducted from wages on each payday, matched by the employer, and sent to the Internal Revenue Service. The table shows the tax rate that must be paid by both employers and employees.

Employer and employee tax rates

Years	For cash benefits (%)	For hospital insurance (%)	Total (%)
1985	5.70	1.35	7.05
1986–1987	5.70	1.45	7.15
1988–1989	6.06	1.45	7.51
1990 and after	6.20	1.45	7.65

In 1989 the maximum taxable earnings level is $48,000 for employees and self-employed individuals.

7.2 Self-Employed People

Self-employed individuals who have $400 or more in net earnings for a year must report their earnings and pay self-employment tax. Self-employed people also currently receive a credit of 2 percent of self-employment income against the self-employment tax. The following table represents rates for self-employed persons before the tax credit.

Self-employed tax rates (before credit)

Years	For cash benefits (%)	For hospital insurance (%)	Total (%)
1985	11.40	2.70	14.10
1986–1987	11.40	2.90	14.30
1988–1989	12.12	2.90	15.02
1990 and after	12.40	2.90	15.30

A self-employed person who has net earnings of $400 or more in any year should file the following forms:

— Form 1040 (U.S. Individual Income Tax Return)

— Schedule C (Profit or Loss from Business or Profession) or Schedule F (Farm Income and Expense)

— Schedule SE (Computation of Social Security Self-Employment Tax)

7.3 Religious Exemptions

The following are exempt from self-employment tax.

— Members of religious orders who have taken a vow of poverty

— Clergy (may elect coverage)

— Members of religious sects opposed to insurance

7.4 Elimination of Certain Employee Exemptions

Beginning in 1988, wages paid to a child over eighteen years of age employed by a parent in the parent's unincorporated trade or business are subject to Social Security taxes. In addition, wages of a spouse employed in the spouse's unincorporated trade or business are subject to Social Security taxation.

Prior to 1988, casual agricultural wages under $150 per person per year were not subject to Social Security taxes. Beginning in 1988, this exemption applies only if the agricultural employer's total payroll is under $2,500 per year.

7.5 Nonfarm Optional Method

Self-employed individuals who are not engaged in farming may continue coverage through the nonfarm optional method even when their self-employment activity generates a loss or small net profit for the year. The following tests must be met:

1. Actual nonfarm self-employment net earnings are less than $1,600.
2. Nonfarm self-employment net earnings are less than two-thirds of total gross income from nonfarm self-employment.
3. The individual must be self-employed on a regular basis. To qualify for this test, actual net earnings from self-employment must be $400 or more in at least two of the three preceding tax years.
4. The individual cannot use this method more than five years in a lifetime.

If the above tests are met and gross income from all nonfarm business is $2,400 or less, two-thirds of the gross income from the nonfarm business may be used as net earnings from self-employment.

Example 1. Gene Brown meets all four tests listed above. Gene's gross self-employment income was $2,000 with net earnings of $500. Gene's net earnings are less than $1,600 and less than two-thirds of his gross earnings. Gene may report actual earnings of $500, or use the optional method and report earnings of $1,333 (two-thirds of $2,000).

Example 2. Assume the same facts, except Gene has a net loss of $300. Gene may use the optional method to report earnings of $1,333 (two-thirds of $2,000).

Example 3. Assume Gene has gross earnings of $500 and net earnings of $100. Gene cannot use the optional method since two-thirds of his gross income ($333) is less than the minimum income requirement of $400.

7.6 Farm Optional Method

The farm optional method allows continuation of self-employment tax coverage when net profit is small or a loss is incurred. There are fewer restrictions on the farm optional method than on the nonfarm method.

There is no test of regular self-employment, actual net earnings may be less than two-thirds of gross income, and there is no limitation on the number of times this method may be used.

Example 1. Jay Steer has a gross income of $25,000 and net earnings of $1,000. Jay may use the optional method to report self-employment income of $1,600.

Example 2. Assume the same facts as Example 1, but substitute that Jay has a net loss of $5,000. Jay may still use the optional method to report self-employment income of $1,600.

8. INCOME TAX LIABILITIES ON BENEFIT PAYMENTS

People having substantial income in addition to their Social Security benefits may have to pay income tax on as much as half of their benefits. To determine if a person must pay tax, compute his or her adjusted gross income, plus tax-exempt interest, plus one-half of Social Security benefits, and subtract

$25,000 for a single taxpayer.
$32,000 for a married couple filing a joint return.
$0 for a married person living with a spouse at any time during the year and filing separate returns.

If the figure reached is positive, the taxpayer pays tax on the lesser of half of this figure or half of the Social Security benefits.

Example. Charles and Diana receive annual Social Security benefits totaling $7,200. In addition, the couple has adjusted gross income of $28,000 annually and $3,000 annually in tax-exempt interest. To compute their income tax liability as a married couple filing jointly, Charles and Diana must:

Add adjusted gross income	$28,000
to tax-exempt interest	3,000
and one-half of SS benefits	3,600
	34,600
And subtract the exempt amount for a married couple filing a joint return	(32,000)
	$ 2,600

Charles and Diana now pay income tax on half the $2,600 figure calculated above or on half their Social Security benefits, whichever is the lesser amount (in this case they would pay tax on half of $2,600).

Social Security benefits include

— Any Medicare medical insurance premiums that have been deducted from a person's check.
— Any overpayments not repaid in the year received.
— Any lump-sum payment of monthly benefits received.
— Any worker's compensation checks that cause a reduction in Social Security disability checks.

9. MISCELLANEOUS SOCIAL SECURITY ITEMS

9.1 Verification of Records

The SSA keeps earnings records throughout a worker's lifetime. To verify that earnings have been recorded accurately and plan the financial future a worker can request his or her own "Personal Earnings and Benefit Estimate Statement" by completing Form SSA 7004 PC entitled "Request For Earnings and Benefit Estimate Statement." The form may be requested by calling the toll-free number (1)(800)937-2000 or by contacting the local Social Security office or writing to the Consumer Information Center, Department 55, Pueblo, CO 81009.

9.2 Direct Deposit

To protect checks from being lost or stolen and to ensure that checks are deposited as soon as possible, Social Security offers direct deposit. Workers can arrange for direct deposit of checks into the financial institution of their choice by requesting a direct deposit form, SF-1199. Some financial institutions charge a fee for this service.

9.3 Sources of Information

Information publications on Social Security can be obtained by writing to local Social Security offices, the addresses of which appear in local telephone directories, or from the American Association of Retired Persons:

AARP
1909 K Street, N.W.
Washington, D.C. 20049

9.4 Unique Social Security Problems for Farmers

Retired farmers age sixty-five or older, still in possession of crops or livestock, will have the subsequent sale of such items excluded from the annual earnings test. To protect from an adverse earnings-test determination when old carryover items are being marketed, at the time drawing of benefits begins the retiring farmer should advise the SSA of how much crops and livestock remain in his or her possession.

9.5 The "Notch Effect"

The "notch effect" refers to the fact that some persons born between 1917 and 1921 receive benefit amounts that differ slightly from those paid to persons born in other years.

The notch effect results from an attempt by Congress to correct an error made in computing the cost-of-living increase in 1972. This error resulted in a benefit formula that over adjusted for inflation. To ease the transition from the old to the new formula, special computation provisions apply to workers born between 1917 and 1921. Their benefits are figured two ways—under the new indexing method and under a modified version of the method in effect before the 1977 Social Security Amendments. Workers in these age groups are paid a benefit rate based on the higher of the two calculations. Workers born after 1921 have their benefits figured only under the indexing method.

9.6 Preretirement Tax Planning Software

The Social Security Administration has begun to offer preretirement tax planning software—a program that computes Social Security benefits. Gratis copies may be obtained by sending a blank formatted IBM PC (or compatible) 5-1/4 inch disk and a preaddressed, stamped, return mailing disk holder to the U.S. Department of Health and Human Services, Office of the Actuary, Room 700, Altmeyer Bldg., Baltimore, MD 21235; tel. (301) 965-3014.

The software is an interactive program written for the IBM PC and compatibles. It computes the Social Security primary insurance amount for an old-age, survivor, or disability benefit, given the characteristics of a particular worker. It also computes the maximum family benefit and, for old-age and survivor cases, the actuarial reduction or increment factor and monthly benefit amount in single-benefit cases.

The program is menu-driven. All requests for input are accompanied by text giving a brief explanation of what is requested. Users are expected to be generally familiar with the structure of the Social Security application process and benefit administration (e.g., that benefits can be paid to retirees, survivors, or disabled workers, and so forth).

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HIRING FOREIGN NATIONALS

HIRING FOREIGN NATIONALS

1. BASIC PREMISES

1.1 Source and Scope of the Federal Power to Regulate Immigration

The right of a foreign national to enter or stay in the United States is set by Congress.* The principal statute governing the status of non-U.S. citizens (aliens) in this country is the Immigration and Naturalization Act. The act's goal, relative to aliens working in the United States, is that jobs should go first to U.S. citizens. The act presumes that any person who wants to enter the United States is seeking to stay permanently, that the person is or will become an immigrant. The burden is on the alien to prove that he or she is entitled to temporary admission by showing that he or she falls within one of the nonimmigration visa categories.

A visa is permission to apply to enter the country. It is issued by a U.S. consulate and is presented to an officer of the Immigration and Naturalization Service (INS) at the port of entry. A visa permits the alien to travel only to the U.S. entry port; the INS then admits the alien to the United States.

1.2 Government Agencies and Their Functions

1.2.1 Immigration and Naturalization Service (INS)

The INS has jurisdiction over the alien from the time of entry to departure. It has both a service and an enforcement function. Service consists primarily of acting upon applications and petitions for benefits under the law; examples would include certain categories that involve employment (H and L visas) when INS gives preliminary approval before the U.S. consulate will consider issuing the visa. For immigrant visas, the INS determines into which category, for preference purposes and so forth, the application falls.

At the U.S. border, the INS has the final say on whether to admit the alien. The INS will determine whether the alien is excludable under any of the thirty-three grounds for exclusion set out in the act. Most of the time, however, the alien is routinely admitted, since the U.S. consulate has already passed on those questions.

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*For the organization and development of this chapter, we are indebted to the *Immigration Handbook: Employment of Foreign Nationals,* 2d ed., rev., American Council on International Personnel, Inc., New York, N.Y., 1985.

1.2.2 State Department

The U.S. State Department operates U.S. consulates in foreign countries. The U.S. consulate is the office that actually issues both nonimmigrant and immigrant visas. It determines whether the alien qualifies for a nonimmigrant visa, rules on the alien's intent to leave the United States at the expiration of his visit, and determines whether the alien is ineligible for a visa under the thirty-three grounds for exclusion.

The appropriate U.S. consulate receives the approved petition from the INS, makes the final determination (including whether any of the thirty-three grounds for excludability apply), and interviews the petitioner.

1.2.3 Department of Labor (DOL)

Certain categories of immigrant visas are granted based upon an offer of permanent employment. Department of Labor approval is necessary only if the offer of employment is itself the basis for eligibility for immigration.

The DOL must certify to the INS that

— There are not sufficient U.S. workers who are able, willing, qualified, and available to perform the work.

— The employment of a foreign national in the position offered will not adversely affect the wages and work conditions of U.S. workers similarly employed.

For nonimmigrant visas, the DOL certification is limited to temporary labor certification for H-2 petitions and is advisory only.

2. NONIMMIGRANT VISAS

2.1 Presumption of Immigrant Intent

Unlike immigrant visas, nonimmigrant visas are not subject to numerical limitations and, thus, have a simplified application process. The alien applies to the U.S. consulate of his country of residence or citizenship. Temporary workers, trainees, or intracompany transferees, or fiance(e)s of U.S. citizens must first apply for INS approval before submitting the visa application to the U.S. consulate.

As noted above, the Immigration and Naturalization Act presumes that every alien applying for a visa to enter the United States intends to stay, and it is up to the alien to prove qualification under one of the nonimmigrant categories and that the stay will be a temporary one.

The alien's passport must be valid for at least six months beyond the expiration of his intended stay in the United States. If not, the U.S. consulate will not issue the visa.

Canadian nationals and Canadian landed immigrants (permanent residents) with common nationality (British Commonwealth citizenship) do not need nonimmigrant visas to enter the United States for temporary periods. They can simply go to the port of entry with the supporting documentation; that is, they skip going to the U.S. consulate and go directly to the INS at the border.

2.2 Evidence That Alien Will Depart

An alien must show that he or she has a residence in a foreign country and has no intention of abandoning it.

The U.S. consulate will consider the following factors to show that the alien intends to return to a home in a foreign country:

— Employment

— Property ownership

— Substantial assets outside the United States

— Membership in religious, social, political, or cultural organizations

— Family ties

2.3 Nonimmigrant Categories (Generally)

The following list includes those nonimmigrant categories of most interest to prospective employers. Omitted, for example, are visas for diplomats or crew of foreign vessels passing through U.S. ports.

2.3.1 B-1 business visitors

B-1 is the category for aliens visiting the United States temporarily for business purposes.

A visitor for business purposes may be intending to negotiate a contract, consult with business associates, engage in litigation, attend a business convention, or perform independent research. If the alien receives any payment, other than reimbursed expenses, from a U.S. source, he or she cannot qualify under this category. He may, however, qualify as a temporary worker under another nonimmigrant category.

B-1 visas can be granted for up to one year, with six-month extensions. The reciprocity granted by the alien's country to U.S. visitors is considered in setting the term of stay.

The initial application is made at the U.S. consulate in the country where the alien resides. It should include a letter from the employer explaining the business purpose for traveling to the United States and proof of financial arrangements to demonstrate that the alien does not need to accept local employment for support while in the United States. The alien must also prove intention to return to the foreign residence. Extensions may be obtained by filing INS Form I-539 with the INS district office having jurisdiction over the alien's location in the United States and should be accompanied by a letter from the alien's employer explaining why the extension is needed and providing further proof of financial support.

2.3.2 B-2 visitors for pleasure

The B-2 category includes tourists, those coming to the United States for medical treatment, attendees at nonbusiness conventions, and amateur entertainers and athletes. The visa is generally granted on a reciprocity basis. For most European countries that do not require U.S. citizens to have visas to visit, visas are granted to nationals of those countries for indefinite duration. At the point of entry, INS generally admits visitors for periods of six months. Extensions can be obtained if the alien can demonstrate sufficient ties to the home country and the financial resources to accommodate a long visit without the need to accept local employment.

As with category B-1, the B-2 visitor applies at his or her local U.S. consulate and submits proof of financial arrangements and intent to return to the foreign residence.

2.3.3 E-1 treaty traders

If an alien is a national of one of the approximately thirty countries that have a trading treaty with the United States, he or she may enter the United States solely to carry on substantial trade principally between the United States and the country of which he or she is a national.

The enterprise must be majority-owned by the nationals of the treaty country. The alien must be employed in a supervisory or executive capacity or in a position involving skills essential to the enterprise's operation. The volume of trade must be substantial.

Trade means goods for money, not services. It includes international banking, insurance, transportation, communication, and newsgathering.

An E-1 visa gives unlimited entry for a total period of four or five years, depending on the alien's country. INS generally admits treaty nationals for one year, with one-year extensions. Every time treaty traders travel, they are given a new one-year admission, so extensions are rarely needed.

Extensions are applied for on INS Form I-539 together with INS Form I-126, the report form for treaty nationals. Treaty traders are usually permitted to stay as long as they are employed by the treaty enterprise, which can be ten or even twenty years, as long as they manifest an intention to return home eventually.

A treaty trader applies for an E-1 visa at a U.S. consulate located outside the United States. No preliminary INS application is needed. The application is made on State Department Form OF-156, submitted with evidence that

— The trading enterprise is majority owned by treaty country nationals.

— The enterprise is engaged in substantial trade principally between the United States and a treaty country.

— The alien is a citizen of that country.

— The alien will be employed in a qualifying position with the treaty enterprise.

A dependent of the treaty trader will not receive INS authorization for local employment in the United States, but accepting employment is not a violation of status that will lead to deportation. Employment is, however, a violation that prohibits adjustment of status to permanent residence—which only means that application for a change of visa to an immigrant visa must be made outside the United States.

Treaty trader countries include Argentina, Austria, Belgium, Bolivia, Brunei, China (Taiwan), Colombia, Costa Rica, Denmark, Estonia, Ethiopia, Finland, France, Germany, Greece, Honduras, Iran, Ireland, Israel, Italy, Japan, Korea, Latvia, Liberia, Luxembourg, Oman, Netherlands, Nicaragua, Norway, Pakistan, Paraguay, Philippines, Spain, Suriname, Switzerland, Thailand, Togo, Turkey, United Kingdom, Vietnam, and Yugoslavia. The treaty with Vietnam is not currently in force, but the treaty with Iran is. United Kingdom nationals who are nonresidents in the United Kingdom proper or Gibraltar are not considered treaty nationals.

2.3.4 E-2 treaty investors

The E-2 visa category is for the benefit of nationals of treaty countries who make a substantial investment in the United States or who are executives, managers or key employees of a treaty investor enterprise. The enterprise must be majority-owned by the treaty country national.

The investment must be an active one, that is, not passive such as equities or real estate. The amount invested must be at risk, and must be substantial—the enterprise cannot be a marginal one.

In other respects, the E-2 classification is like the E-1 category, except that E-2 countries do not include Bolivia, Brunei, Denmark, Estonia, Finland, Greece, Ireland, Israel, Latvia, and Turkey.

2.3.5 F-1 student

An F-1 visa is granted to students who have no intention of abandoning their foreign residences, who enter the United States temporarily in order to attend an academic program.

— The school must be approved for F visa purposes by the U.S. Attorney General.

— The student must be enrolled in a full course of study.

— The student must be proficient in English or enrolled in English proficiency courses.

— The student must have sufficient funds for the expenses for the full course of study.

The F-2 visa is for family of an F-1 student. INS Form I-20 is issued by the school to the student. Application for entry is made at the U.S. consulate abroad; no advance INS permission is needed. Form OF-156 is used, accompanied by I-20 from the school. The student must also submit financial documentation and evidence that he will depart at the end of his course of study.

The student's visa is for the duration of status—that is, the time necessary to finish the course of study. Transfer from one school to another while still in the course of study does not require INS approval. A change of academic program is applied for on student extension form INS Form I-538.

An academic student may accept employment in a school-run program as long as a U.S. citizen or resident is not displaced. Teaching in a fellowship program is permitted. No off-campus employment is permitted to an academic student during the first year in the United States, and a student spending one year or less in the United States is not permitted to accept off-campus employment at all. Thereafter, the student may accept off-campus employment after applying for permission to the INS. Employment can be authorized where the student can demonstrate that economic circumstances unforeseeable at the time of the initial application have occurred which necessitate employment. Moreover, a student may receive permission to engage in practical training for up to one year upon graduation. The student must demonstrate that comparable training is not available in the home country and that the training is in furtherance of the academic program. Employment may be full-time during school recesses. Any practical training taken during summer recess will be deducted from the one-year allotment. A student's family member with an F-2 visa may not work under any circumstances.

2.3.6 H-1 temporary worker of distinguished merit and ability; professionals

The H-1 category is for aliens of distinguished merit and ability, coming temporarily to the United States to perform exceptional services requiring their merit and ability. Included within this definition are persons of international acclaim as well as professionals. A professional is defined as a person possessing at least a baccalaurate degree, where the attainment of such a degree is a minimum prerequisite to engage in that occupation. Examples include doctors, engineers, teachers, lawyers, and Ph.D.-level scientists. However, a special restriction limits the H-1 category to medical school graduates invited to teach or conduct research at public or nonprofit organizations.

The employer must obtain INS permission. He files a nonimmigrant visa petition on INS Form I-129B, together with evidence to show that

— The position requires a person of distinguished merit and ability.

— The proposed employee has the necessary credentials.

— The employer's intent is for a temporary period.

After the INS approves the petition, it sends notice of approval to the employer on Form I-171C. The approved petition is forwarded to the U.S. consulate abroad, where the employee applies for an H-1 visa, using State Department Form OF-156.

The employee includes evidence of his intent to depart at the expiration of his stay. If the alien is not a professional, such as an athlete or an artist, he or she should document renown and preeminence in a field.

The approved petition is valid for the period of established need, not exceeding two years. The U.S. consulate then issues a visa for a period equal to that granted by the INS. The alien is admitted to the United States for the full period of validity of the petition. Extensions are available for one-year periods. There is a limit on the number of extensions of a total stay of five years except that one additional year may be obtained in exceptional circumstances. The INS will then examine the situation closely to verify that there is continuing intent for the alien to leave the United States after the completion of his assignment. The employer's extension request is filed on INS Form I-129B, and the alien's extension request, on INS Form I-539.

The H-1 category automatically entails employment authorization. Family members, who receive category H- 4, cannot receive employment authorization unless they qualify on their own for a visa category with employment authorization.

2.3.7 H-2 temporary worker; H-2A agricultural worker

The H-2 visa category is for skilled or unskilled workers on a temporary basis, if U.S. workers cannot be found to fill the positions, excluding foreign medical school graduates. H-2A is for agricultural workers.

The employer must show that

— There is a temporary need for the type of services or skills to be rendered by the alien.

— There are no U.S. workers available who are unemployed and qualified to fill the position.

The employer shows that the need is temporary by such factors as the lack of an ongoing or continuous need in the employer's organization for the skills possessed by the alien, for example, a special project, an instructor, or technicians to install a new system, or work recurring by cyclical need, such as in agriculture (laborers needed during harvest times) or in resort hotels (larger staff needed during vacation months).

The employer demonstrates that there are no U.S. workers by getting a temporary labor certificate from the Department of Labor. This differs from the labor certificate needed for permanent residence in that it is advisory only. INS makes final the decision.

Note that it is extremely difficult to move from H-2 to permanent resident status while the foreign employee is in the same position. It would be contradictory for the employer to say that the position, which was temporary, is now permanent.

The employer first obtains a temporary labor certificate from the DOL by filing DOL Form ETA 750, Part A. Once the certificate is obtained, or the DOL declines to certify, the employer files the nonimmigrant visa petition with the INS, INS Form I-129B. Form I-129B must be accompanied by the DOL certificate or evidence rebutting the DOL determination that U.S. workers are available. The employer can file for more than one employee at a time.

Once the INS approves the petition, the alien must obtain the H-2 visa at the U.S. consulate outside the United States, and be admitted to the United States under that visa. The alien does so by filing State Department Form OF-156, accompanied by the INS approval notice to the employer, plus evidence of intention to leave the United States upon expiration of the stay.

The visa is for a maximum initial period of one year. Extensions are available each year, up to a maximum of three years. The extension is obtained by the employer's obtaining a temporary certification from the DOL, and then filing extension requests on INS Form I-129B. The employee asks for the extension with INS Form I-539. Both forms can be filed simultaneously with the INS office covering the employer's location.

The family of an H-2 alien comes under the H-4 category.

2.3.8 H-3 trainee

The H-3 category is for aliens coming temporarily to the United States as trainees, other than for graduate medical education or training. It generally applies to employers who bring aliens to the United States for a temporary period of training in an established program. The program can be in a classroom and/or on-the-job, but it cannot displace any U.S. workers. The employer must show that

— The training is pursuant to an established training program run by the employer.

— The training is not available in the home country of the alien employee.

— Any productive employment is incidental to the training program and does not displace U.S. workers.

For the last requirement, a rule of thumb applies: If the alien were not filling the position, would the employer need to fill the position as part of normal operations? If yes, then there is displacement.

The employment must be for a temporary period, and the alien must intend be in the United States temporarily. The training does not *have* to be for the employer's foreign branch, but cannot be for a U.S. branch.

The employer files INS Form I-129B, including documentation on the training program. The INS approves it on INS Form I-171C. The alien trainee then submits the nonimmigrant visa application, State Department Form OF-156, to the U.S. consulate, together with evidence that he will depart at the expiration of his stay.

The visa is granted for the full length of the training program—generally no more than two years. Extensions are difficult to obtain, but to do so, the employer must file Form I-129B and the employee must file Form I-539.

As with H-1 and H-2, family members of H-3 aliens are category H-4.

2.3.9 J-1 exchange visitor

The J-1 category is for a student, scholar, trainee, teacher, or other who is coming temporarily to the United States to participate in a program designated by the United States Information Agency (USIA). The USIA has the authority to designate program sponsors and the terms of the exchange visitor program. Some programs permit employment, some require it, and some prohibit it.

An alien selected to participate in a sponsor's program receives a certificate of eligibility from the sponsor on USIA Form IAP-66. The alien then takes the form to the U.S. consulate abroad together with evidence of intent to leave the United States upon completion of participation in the program. No preliminary INS approval is needed before the alien applies for a nonimmigrant visa on State Department Form OF-156, and is issued a J-1 visa by the U.S. consulate.

The visa may be granted for up to eighteen months for business and industrial trainees and for other time limits for academics. The certificate of eligibility is issued for one year, with an extension of up to an additional six months granted upon completion of the one year. The extension application is made to the INS office having jurisdiction over the location where the alien resides in the United States. Form IAP- 66 is used, not Form I-539 (used for extension requests in other categories).

An exchange-visitor student may be employed if

- An urgent financial need arose since acquiring exchange-visitor status.
- The employment does not interfere with school.
- The alien obtains written approval of the exchange program's sponsor.

Full-time employment is permitted only during school vacations. No specific permission from the INS is required. For teenage students, employment is only permitted up to ten hours per week, and only in noncompetitive jobs such as tutoring, grass cutting, babysitting, and newspaper delivery.

The family of a J-1 alien comes under category J-2. Spouses can obtain permission to work from the INS. The spouse must show that employment is necessary for family support, but not for each visitor himself, because the sponsor is supposed to make sure of the visitor's means of support before issuing the certificate of eligibility.

2.3.10 L-1 intracompany transferee

The L-1 category is for an alien who, for the prior year, has been employed by a company that seeks to transfer the alien temporarily to a

U.S. branch of the same company to render managerial or executive services, or services that require specialized knowledge.

The foreign employer and the U.S. employer must be related as a parent, subsidiary, or affiliate. To be a parent, subsidiary, or affiliate, one company must have effective control of the other, or, a third company, individual, or group of individuals must have effective control over both the foreign and the U.S. employer. Less than 50 percent control is permissible if the party with less than 50 percent has authority to name top managers, make important corporate decisions, and direct the day-to-day operations—for example, the control group owns a substantial bloc of stock and the rest of stock is widely dispersed.

Managerial duties means that the employee directs the organization or a recognized department, controls the work of other employees, and has authority to hire and fire or recommend the hiring or firing of personnel. It doesn't include first-line supervisors, unless the employees supervised are professionals. *Executive duties* means that the employee directs the management of the organization, establishes goals, and has a wide latitude of discretionary decision-making. *Specialized knowledge* means that the employee's knowledge is central to the organization's operation, such as secret formulas or procedures. Secretaries, for example, rarely qualify.

The employer files INS Form I-129L, with supporting evidence, and the INS approves it on Form I-171C. The employee then goes to the U.S. consulate abroad to apply for the nonimmigrant visa. The alien may show intent to depart at the expiration of his or her stay by showing that he or she was employed by the petitioning company for over a year and is subject to its policy of international transfers.

The INS usually grants permission for three years; the U.S. consulate issues the visa for same period; and the alien is then admitted at the border for same period. One-year extensions are available, with each extension more difficult to gain than the last. Extensions beyond the fifth year are virtually impossible to gain. One additional year in exceptional circumstances is permitted. To get an extension, the employer files Form I-129L and the employee files Form I-539.

If employers transfer five or more managerial or executive employees in the preceding year, they can get blanket approval from INS for intracompany transfers of managers and executives. There is no blanket approval available for specialized-knowledge employees. The employer applies for blanket approval on Form I-129S. The employer gives evidence of affiliated relationship of all offices, and designates all positions to or from which transfers may be made. INS then issues an approval notice that names the company divisions and transferee positions that qualify. The approved blanket petition is forwarded to the U.S. consulate. The employee then only has to prove to the consulate that he or she has one-year employment in a managerial or executive role with the appropriate division of the organization and intends to leave the United States at the expiration of the employment.

Family members of L-1 aliens come under category L-2. They have no authority to work unless they separately qualify for some other status.

2.3.11 M-1 nonacademic or vocational students

An M-1 visa is granted to students who have no intention of abandoning their foreign residences, who enter the United States temporarily in order to attend vocational or nonacademic training programs. This category is similar to F-1, except for the nonacademic nature of the program.

The U.S. attorney general must recognize the school as a qualified institution. Then the school issues a certificate of eligibility on INS Form I-20M-N to the student. The student brings the form to the U.S. consulate abroad to obtain the M-1 visa. The student must present proof of financial resources to cover expenses without employment in the United States, proof of English proficiency, and proof of intent to depart the United States at the expiration of the stay. The student must also prove that the training to be received can be used in the home country and that it is unavailable at comparable quality and cost in the home country.

The visa is granted for a maximum of one year. Extensions are requested on INS Form I-538.

Vocational/nonacademic students may not accept employment outside of the training program while in the United States. However, as part of the training program, the INS may authorize one month of practical training for every four months of education, up to a maximum of six months. The student applies for permission to take practical training on INS Form I-538. Training must be related to the course of study and be unavailable in the home country.

3. LAWFUL PERMANENT RESIDENCE

A *permanent resident* is an alien who has received indefinite permission to live and work in the United States. A permanent resident is sometimes referred to as a "green card" holder, but today, the card is printed on white paper.

Permanent residence (and therefore, immigration) is confined to

— Special immigrants.

— Immediate relatives of U.S. citizens.

— Close relatives of citizens and permanent residents.

— Persons with offers of permanent employment in the United States when U.S. workers are in short supply.

An alien qualifies for permanent residence by applying for an immigrant visa while abroad or by adjustment to permanent residence status in the United States after making a valid nonimmigrant entry.

The law sets no limit on the number of special immigrants or immediate relatives who may obtain permanent residence status, but it sets a yearly limit of 270,000 on all others, with a maximum number in each preference category and a maximum number from each foreign state and dependent area.

3.1 Based Upon Immediate Relative

3.1.1 Definition

Immediate relatives of a U.S. citizen include

— Children (under the age of 21).

— Spouses.

— Parents (provided the citizen is over 21).

The term *spouse* means legally married, even if currently separated, as long as the marriage was bona fide and there has been no legal separation agreement or divorce. Marriages entered into for immigration purposes are not bona fide.

Children means unmarried sons and daughters under age twenty-one. A stepchild is considered a child if the step relationship was formed before the child turned eighteen. An adopted child is considered a child if adopted before age sixteen, together with other requirements. An illegitimate child is considered a child of the mother. For sons and daughters married or over 21, see section 3.2.

Parents of a U.S. citizen (if U.S. citizen over 21)—is a requirement designed to discourage foreign nationals from coming to the United States to give birth to their children in order to have them immediately sponsor the parent for permanent residence. Natural fathers will be entitled to receive or petition for benefits if the father has or had a bona fide parent-child relationship.

3.1.2 Procedure

The U.S. relative is the *petitioner* and the alien is the *beneficiary*. The petition is filed on INS Form I-130 with the INS office covering the U.S. relative's residence, unless the alien is in the United States and eligible for adjustment of status. The alien's place of U.S. residence would determine the INS office for filing purposes. If both petitioner and beneficiary are located in the same consular district abroad at the time of petition filing, the petition must be submitted to the INS office covering the U.S. relative's residence. The petition is filed together with

— Evidence of U.S. citizenship of the petitioner, such as a birth certificate, certificate of naturalization, or unexpired U.S. passport.

— Birth certificate of the beneficiary, showing the names of the parents.

— If beneficiary is petitioner's spouse, the marriage certificate of the parties, plus evidence of termination of all prior marriages.

— If the petitioner is the father of the beneficiary, the parent's marriage certificate and evidence of termination of all prior marriages.

— If the petitioner is the child of a male beneficiary, the birth certificate of the petitioner and the parents' marriage certificate and evidence of termination of all prior marriages. If petitioner is the child of a female beneficiary, simply the child's birth certificate showing the mother's full name is sufficient.

— If the petitioner is the brother or sister of the beneficiary through a common mother, the birth certificates of both parties. If the relationship is through a common father and different mothers, the parents' marriage certificates and evidence of termination of all prior marriages.

— If the parent-child relationship is based on adoption or legitimation, a certified copy of the adoption decree or evidence of legitimation.

— If either the petitioner or beneficiary is a married woman, her marriage certificate, to show change of natal surname.

The INS may investigate when documents cannot be produced. If a marriage has attributes typical of a sham, an investigation, lasting years, is likely.

If the alien's relationship is based upon a marriage that occurred less than twenty-four months previously, he or she is conditionally admitted. The alien beneficiary and the petitioner must file a petition within ninety days of the second anniversary of the conditional admission to prove that the marriage was bona fide. If no petition is filed, or if it is denied, the alien may be deported.

If an immigrant relative petition is denied, the denial can be appealed to the Board of Immigration Appeals in Washington, D.C. After administration appeals are exhausted, the denial can be subject to review in the federal district courts.

3.2 Based Upon Special Immigrant Status

Special immigrants include

- — Permanent residents returning from temporary visits abroad.
- — Former U.S. citizens reapplying for citizenship.
- — Ministers of religious orders (accompanied by their spouses and children) who have been engaged in their religious vocations for at least two years and whose denominations have a bona fide U.S. organization.
- — Certain employees of the U.S. government or the Panama Canal Company.
- — Doctors (accompanied by their spouses and children) who have been licensed to practice medicine in a state before October 10, 1978, and have been practicing or studying medicine in the state since then.
- — Certain officers of international organizations and their families who have lived in the United States for a lengthy period.

Practically viewed, very few persons qualify as special immigrants.

3.3 Based Upon Family Preferences

With the exception of immediate relatives of U.S. citizens and special immigrants, all other classes of immigrants are subject to numerical limitations. There is a worldwide ceiling of 270,000 immigrant visas per fiscal year. (The federal government fiscal year ends September 30.)

There is a per-country ceiling of 20,000 visas per year. Dependencies of independent states receive a maximum of 600 immigrant visas per year. Effective October 1, 1987, the dependency quota will be increased to 3,000. Presently most countries don't come close to their maximum, but certain countries, such as the Peoples' Republic of China, India, Korea, Mexico, the Philippines, and Hong Kong (Hong Kong is a dependent area with a 600 limit) have long waiting lists.

An alien is charged to the country of his or her birth, not the country of residence. However, there are some exceptions:

- — A spouse is charged to the other spouse's place of birth when a visa is not available from the spouse's country.
- — Minor children (under 21) are charged to the place of birth of the parent whom they are accompanying to the United States.

— Former U.S. citizens by birth are charged to the country of citizenship; if stateless, to their country of residence.

— A person born in a country in which neither parent was born may be charged to either parent's place of birth if the parents did not have a residence and they had no intention to remain indefinitely in the country of the child's birth at the time of birth. This was considered the missionary clause: Children of missionaries on temporary assignment in a populous foreign state could receive more beneficial visa chargeability from the parents' native country. It has proved most useful, however, for Hong Kong–born Chinese whose parents were in Hong Kong temporarily while fleeing either the Japanese during World War II or the communist forces following the war.

The 270,000 annual visas are apportioned among six preference categories. It is possible that a country will not have used its maximum 20,000, but that no visas are available to it in a particular preference category. Of the six preferences, four are family preferences: the first, second, fourth, and fifth.

— *First Preference:* Unmarried sons and daughters of U.S. citizens, 20 percent of 270,000. This means sons and daughters over twenty-one, since children under twenty-one are immediate relatives (no numerical limit). In practice, this category is not used up, and the excess is allocated to the second preference.

— *Second Preference:* Spouses and unmarried sons and daughters of permanent residents, 26 percent of 270,000. This means all unmarried children of residents, over or under age twenty-one. Usually, family members of permanent residents will become residents at the same time, but children over age twenty-one can't qualify for derivative status. "Unmarried children" includes divorced or widowed persons. All visas are currently being used; if there were any excess, it would go to the fourth preference, the next *family* category.

— *Fourth Preference:* Married sons and daughters of U.S. citizens, 10 percent of 270,000. This includes all married offspring, whether over or under age twenty-one. The spouse and child of a qualifying son or daughter are also included. Unused visas are available to the fifth preference.

— *Fifth Preference:* Brothers and sisters of U.S. citizens, 24 percent of 270,000. The U.S citizen must be 21 or over and must have a common parent. The spouse and child of a qualified sibling are included. It has the longest waiting list.

The procedure to be followed is essentially the same as with immediate relatives.

3.4 Based Upon Employment

3.4.1 Third and sixth preference categories

The third preference is for those professionals with exceptional ability in science or art whose services are sought by U.S. employers; this category represents 10 percent of 270,000. Before the INS will classify a person as third preference, the employer must obtain a certificate from the Department of Labor that no U.S. worker is available who is qualified and willing to fill the position.

Exceptional ability can be shown by demonstrating international renown in a field or qualification as a professional. Artists or scholars demonstrate they have been recognized by critics or experts as preeminent; have won awards, published, or had articles published about them; or have been otherwise honored. The field must be science or art—that is, a college degree can be awarded for the field.

A member of a profession must meet the minimum entry requirements for professional standing, such as holding a required degree. This is more of a problem with business positions, because there is frequently no clear-cut standard. An MBA might be indicative.

The sixth preference is for skilled or unskilled labor for which a shortage exists in the United States; this category is 10 percent of 270,000. Sixth preference is a catch-all, and it runs the gamut from "high-level business executives without college degrees to live-in domestic helpers and Chinese specialty chefs." Before the INS will classify a foreigner as sixth preference, the DOL must certify that there is no U.S. worker available who is qualified and willing to fill the position.

3.4.2 Labor certification

Jobs can be separated into two broad categories: those that are in chronic short supply, which have been precertified (see Appendix 2 of this chapter), and those that require individual certification. The labor certification procedure is discussed in detail in section 4, herein.

3.5 Final Application for Immigrant (Permanent Resident) Status

Once INS has approved an alien person for a preference, the alien makes the final application for residence. Two methods are used: If the alien is already in the United States, status may be adjusted at the INS district office with jurisdiction where the alien resides, or the alien may submit an immigrant visa application at the U.S. consulate where the alien resides or last resided abroad.

When the alien is not in the United States, the petition is decided by

INS and sent to the U.S. consulate abroad designated in the petition. At the consultate, the final decision is made, including consideration of the thirty-three grounds for exclusion. Consular officers are generally concerned with financial means, medical infirmities, criminal convictions, and political affiliations. The consulate notifies the applicant when the approved petition is received. If a visa number is currently available under the numerical limitation system, the consulate sends Packet Three, which includes a biographical form, State Department Form OF-169. The applicant gathers all documents and notifies the consulate that he or she is ready for the final interview. At the interview, the applicant takes a medical exam, presents all supporting documents, and two completed copies of State Department form OF-230, the immigrant visa application. The usual supporting documents submitted are

- Applicant's passport.
- Birth and marriage certificates.
- Police certificates from each place of residence of six months or more.
- Any court and prison records.
- Military service records.
- Photos.
- Evidence of financial support in the United States, such as a letter from a prospective employer or an affidavit of support from a relative. All documents must be in English or be presented along with English translations.

3.5.1 Adjustment of status

When aliens are located in the United States, they may be eligible to have their status changed from nonimmigrant to immigrant without having to apply to the U.S. consulate abroad. This is called adjustment of status.

An alien admitted on a temporary visa to the United States may have status adjusted to that of permanent resident if

- He or she was lawfully admitted, or paroled, into the United States. (An alien is paroled into the United States when permitted to enter the United States, although denied nonimmigrant or permanent resident status. He or she is deemed to be still applying for admission at the border. This is used to allow an alien to enter the United States for an emergency although his or her visa application has not been acted upon.)
- The alien is eligible to receive an immigrant visa.
- A visa is immediately available. (This means that either the alien is

applying under a category without a numerical limit, or the backlog for his or her preference class has caught up to the priority date.)

An alien is *not* eligible for adjustment of status if

— Admitted as a crewman.

— Not a relative of a U.S. citizen or resident and continues in or accepts unauthorized employment before filing an application for adjustment of status.

— Admitted in transit without a visa.

— In violation of nonimmigrant status.

— His or her immigration status is based upon a marriage that occurred less than twenty-four months previously, or a marriage that occurred during the pendency of administrative or judicial proceeding regarding the alien's status.

The advantage to adjustment of status is that the alien may remain in the United States while his or her application is processed in the United States. An alien precluded from applying for adjustment of status may apply to a U.S. consul abroad.

The availability of an immigrant visa depends upon the "priority date" the alien has established. The priority date is established at the time of filing first papers—either the immigrant relative preference petition for close family members, the labor certificate application for job offer immigrants, or the preference petition for job offer immigrants precertified under DOL Schedule A.

Since there is no limit on the number of persons who can become permanent residents as immediate relatives of citizens, visas are always immediately available, and the adjustment application can be filed by eligible applicants simultaneously with the immediate relative petition. For preference categories with no backlog, the same holds true. For family preferences with a backlog, the adjustment application cannot be filed with the petition. For job offer preferences in which individual labor certification is sought, even if there is a backlog, the adjustment application can be filed simultaneously with the preference petition, where the priority date established at the time of filing the labor certification application with the DOL is currently available. When the DOL application is approved, if visas are not currently available, the applicant waits until the priority date is reached, and files the preference petition and adjustment application simultaneously. Such an alien must be in a bona fide nonimmigrant status with authorization from INS to remain in the United States.

The adjustment application is filed on INS Form I-485 at the INS office with jurisdiction over the alien's U.S. residence. If the immediate relative or preference petition is filed simultaneously with the adjustment application, both forms are filed together where the foreigner lives, even if the petition alone would have been filed in a different INS office.

The application is filed with a biographical information form, Form G-325A, fingerprints on FBI Form FD-258, and two identical photos. The same forms are required for each family member, except that there is no need to file separate Forms G-325A and FD-258 for family members under 14 years of age. However, documents must establish the family relationship.

Next is the medical exam, then the interview. The INS determines whether any of the thirty-three grounds for exclusion apply. At the interview, the applicant presents his or her passport, INS Form I-94 (arrival/departure card), and medical exam report, together with evidence of financial support, such as a letter from a current employer.

3.6 The Immigration Reform and Control Act of 1986

On November 6, 1986, heated debate over U.S. immigration policy was brought to a close with the Immigration Reform and Control Act of 1986 (IRCA). The history of the IRCA can be traced back to the establishment in 1978 of a select commission that presented its findings in the *Final Report of the Select Commission on Immigration and Refugee Policy* in early 1981. The two key conclusions drawn by the commission and reflected in the IRCA were that legal immigration is beneficial to the United States and that employer sanctions are the most effective means of reducing illegal immigration.

3.6.1 Legalization (amnesty)

One of the major provisions of IRCA granted legalization, and temporary and eventually permanent residence, to approximately three to six million illegal aliens. Beginning on May 5, 1987, and continuing through May 4, 1988, qualified illegal aliens may apply for amnesty.

3.6.1.1 Eligibility for amnesty

The IRCA permits certain undocumented aliens to change their status in the United States to that of lawful temporary resident. Regulations have set the fee for an amnesty application at $185 (with maximum fee for a family unit $420) and the fee for appeal from denial of amnesty at $50.

To qualify, an undocumented alien must apply within the eighteen-month period designated by the attorney general, or within thirty days of a show-cause order issued in deportation proceedings. For purposes of the amnesty, certain Cuban and Haitian entrants are treated as undocumented aliens.

An undocumented alien must have been unlawfully in the United States continuously since 1982. This is satisfied if the alien

— Entered the United States unlawfully before January 1, 1982.

— Entered the United States lawfully as a nonimmigrant before January 1, 1982, but lawful status expired before January 1, 1982.

— Entered the United States lawfully as an exchange student not subject to the two-year foreign residence requirement, has continuously been in the United States since November 6, 1986, and is admissible as an immigrant.

An alien is considered "admissible as an immigrant" if he or she

— Meets all other requirements to be admissible to the United States as an immigrant.

— Has not been convicted of a felony or more than two misdemeanors while in the United States.

— Has not persecuted members of any race or religion.

— Registers for the draft, if required.

An alien seeking amnesty must prove his eligibility by showing documentary proof in three categories: identity, residence, and financial responsibility.

Regulations state that identity can be proven by, in order of preference, a passport, birth certificate, driver's license, baptismal record, marriage certificate, or social security card and affidavits.

Residence can be proven by, in order of preference, past employment records, school records, letters showing church or union membership, and other documents.

3.6.1.2 Seasonal agricultural workers (SAW)

Certain agricultural workers can adjust their status to permanent residents if

— They apply within the eighteen-month period beginning six months after November 6, 1986.

— They performed sixty days of agricultural services in the last twelve months.

— They are admissible as immigrants.

— Application for adjustment of status is made

Within the United States, to the U.S. attorney general or to a designated entity.

Outside the United States, as provided in regulations to be issued.

Numerical limits on visas do not apply to aliens adjusting their status under this provision.

3.6.1.3 Eligibility for subsequent adjustment

Once granted lawful status as a temporary resident, the alien may apply for adjustment to permanent residence status. To qualify, an alien must

— Make a timely application, within the one-year period beginning the thirteenth month after being granted temporary lawful status.

— Have been in continuous residence in the United States.

— Be admissible as an immigrant and not have been convicted of a felony or more than two misdemeanors.

— Have acquired citizenship skills in U.S. history and the English language. This requirement may be shown by passing the naturalization exam, but is an exception for persons over age sixty-five.

The alien is permitted brief trips abroad and to accept employment during the pendency of the application. However, the alien's temporary residence status will be terminated if he or she

— Is discovered to be ineligible.

— Commits a felony or three or more misdemeanors.

— Has not timely applied for permanent residence status.

3.6.1.4 Procedure for adjustment of status

Applications for adjustment of status are made to the U.S. attorney general or to certain designated entities and then forwarded to the attorney general. Designated entities are qualified voluntary organizations and state, local, or community organizations. The designated entities do not make any determination of their own, and their files are confidential.

Numerical limits on visas do not apply to those aliens qualifying under this amnesty program.

4. LABOR CERTIFICATION

The Immigration and Naturalization Act specifies that an alien is ineligible for a visa if he or she is seeking to enter the United States for the purpose of employment *unless* the secretary of labor certifies to the secretary of state and the attorney general that

— There are not enough workers who are able, willing, qualified (or equally qualified if the alien is a teacher or has exceptional ability in the arts or sciences) and available at the time of the application and the place for the job.

— The employment of the alien will not adversely affect the wages and working conditions of similar U.S. workers.

Thus, for aliens seeking visas under the third and sixth preference classes, certification is first required that will meet the foregoing standards. The certification is made by the Department of Labor.

4.1 Employment Classifications

The secretary of labor has established two schedules of occupations. Schedule A includes those occupations for which a predetermined shortage exists, and Schedule B includes those occupations for which an ample supply of U.S. workers exists.

4.1.1 Schedule A—professional

The occupations that are listed in Schedule A include the following groups:

Group I.

— Doctors willing to practice in geographic areas that have a shortage in their specialty.

— Physical therapists qualified to take the licensing examination in the state in which they will practice.

— Nurses who are licensed in the state in which they will practice or have passed the Commission on Graduates of Foreign Nursing Schools (CGFNS) examination.

Group II. Artists and scientists of exceptional ability (excluding performing artists), including college and university teachers who have been practicing their profession for at least a year and intend to practice the same art or science in the United States.

Group III. Aliens planning to preach or teach religion in the United States or those with a religious commitment who intend to work for a nonprofit religious organization (this supplements the special immigrant classification for ministers).

Group IV. Managerial transfers between branches of an international employer; the employee must have worked for the same company in same type of position for one year before admission to the United States and the employer must have been doing business in the United States for at least one year.

4.1.2 Schedule B—low level/entry level

Schedule B includes forty-nine occupations such as clerks, cleaners, receptionists, typists, laborers, and taxi drivers. These are generally low-skill-level or entry-level jobs. An employer may petition for a waiver for any particular job.

4.1.3 Occupations on neither schedule

For Schedule A, there is a predetermined shortage and for Schedule B, a predetermined surplus of U.S. workers. Applications for occupations falling on neither schedule are considered on a job-by-job basis.

4.2 Application for Labor Certification

4.2.1 Who files

The employer files the application for labor certification. The application may be filed on the employer's behalf by an agent, who need not be an attorney. The employer is called the *petitioner* and the alien employee is called the *beneficiary*.

Labor certifications are not required for Schedule A employees. Appropriate documentation to demonstrate Schedule A eligibility is filed together with the preference petition with the INS. Other labor certifications are determined by the Department of Labor.

4.2.2 What must be filed

All employers must show the following:

- The employer has the funds to pay the employee's salary.
- The wage to be paid to the alien equals or exceeds the prevailing wage.
- The wage is based on regular payments, not extras or bonuses.
- The employer is not discriminating on the basis of race, creed, sex, age, or handicap.
- The job is not vacant due to a strike or labor dispute.
- The job opportunity does not violate any laws.
- The job has been open to U.S. workers.
- The application is sworn or affirmed.
- All documents are in English or contain English translations.

4.2.3 Basic certification process

The employer files the application in duplicate on Form ETA 750, Application for Alien Employment Certification. The statement of the alien's qualifications is signed by the alien and the description of the job offer is signed by the employer. The employer also must show that, except for Schedule A occupations, good-faith efforts were made to hire U.S. workers and must show who was interviewed and, for what job-related reason, not hired.

The local job service office will calculate the prevailing wage for the job. If the wage offered by the employer is less, the employer must increase it or the application will be denied.

After receiving the application, the local job service office will attempt for thirty days to recruit a U.S. worker to fill the job, and, during that time, the employer must place advertisements in general circulation periodicals. However, if the employer documents all previous attempts to recruit a U.S. worker, the job service office may reduce or eliminate further recruitment efforts for all jobs except Schedule B occupations.

4.2.4 Schedule A

Applications for Schedule A occupations are filed with the third or sixth preference petition with the INS office in the United States, not with the Department of Labor or state job service office. The alien must show prearranged employment by having the employer complete and sign the job offer description portion of the application.

The INS or Department of State determination whether or not an alien qualifies under Schedule A is final and not subject to review.

4.2.4.1 Schedule A—Special handling

Applications for a college or university teacher or an exceptional performing artist are designated by special handling.

Teacher. The employer must submit documentation to show competitive recruitment, why the alien is better qualified than other applicants, the faculty report evaluating the alien applicant, and copies of the advertisements in professional journals concerning the job opening.

Performer. The employer must show documents attesting to the artist's current widespread acclaim and receipt of prizes or awards, published critical reviews, evidence of earnings commensurate with the claimed level of ability, and playbills from performances.

For the following Schedule A groups, certain specific kinds of evidence or demonstrations must accompany applications.

Group I. The alien must submit proof of license. In addition, if the alien is a doctor seeking work in an understaffed part of the United

States, the alien must submit a statement signed by the Department of Health and Human Services attesting to the doctor shortage in that particular specialty for that particular geographic area. The alien obtains this by written request to the appropriate HHS Regional Health Administrator.

Group II. The alien must submit documentary evidence of international recognition, such as

— Prizes and awards.

— Memberships in organizations.

— Published material about the alien.

— Evidence of work on panel, or other judgments about the alien.

— Original contributions.

— Scholarly publications.

— Evidence of artistic exhibitions in more than one country.

Group III. The alien must show

— Performance of nonprofit religious work for the previous two years.

— Plans to devote more than 50 percent of time in the U.S. to nonprofit religious work.

Group IV. The alien must show

— Continuous employment as a manager or executive for one year by a company for which he is seeking to enter the United States temporarily to perform services for a U.S. branch.

— Written proof of employment, including the dates of employment, the name of the branch, the description of positions held, with dates, unless they appear on the application itself, and the dates the company has been doing business in the United States.

4.2.5 Schedule B

The secretary of labor has determined that allowing aliens to fill Schedule B occupations adversely affects U.S. workers, and thus aliens are generally proscribed from filling Schedule B occupations. Nevertheless, the employer or the employer's agent or attorney may petition for a waiver for a certain job in a specified geographic area.

In order to obtain a waiver, the employer must show documentary verification that he could not fill the job during thirty-days recruitment efforts with the state job service office.

4.2.5.1 Temporary agricultural workers

Due to the nature of the business, employers of agricultural workers have an expedited application procedure.

The employer must show that there are not sufficient U.S. workers able, willing, and qualified, and that employment of the alien will not adversely affect U.S. workers' wages and conditions. Under regulations, the secretary of labor may set a deadline for applications up to sixty days before the job is to start. The secretary will give notice within seven days to the employer if there are deficiencies in the application, and will issue the labor certifications at least twenty days before the job begins. Agricultural associations may apply on behalf of groups of employers, and expedited administrative appeal procedures apply.

An employer's application will be denied if

- There is a strike or lockout.
- During the previous two years, the employer hired temporary agricultural alien workers in violation of the law.
- The employer does not prove provision of worker's compensation.
- The employer does not prove an attempt to recruit U.S. workers.

Any alien violating the condition of a labor certification granted under this provision (for example, working without employment authorization) is disqualified for five years.

4.2.5.2 Live-in domestic workers

For a live-in domestic worker, the employer must submit a statement describing the living accommodations and two copies of the employment contract showing

- Hourly and weekly wages.
- Hours of employment per week and exact hours per day.
- That the alien may leave the premises during off-hours, except if paid overtime.
- That the alien will reside on the premises.
- Duties to be performed.
- Advances made by employer, with details.
- That the alien need not give more than two weeks notice to resign and that the employer will give at least two weeks notice of termination.
- That a copy of the contract was given to the alien.

— That private room and board will be provided to the alien at no charge.

— Any other terms or conditions of employment.

Additionally, the application must document the alien's past work experience, showing at least the equivalent of one year full-time employment as a domestic worker.

4.2.6 Where to file for labor certification

Schedule A. The Application for Alien Employment and the visa petition are submitted to the INS district director at the location of the intended employment.

All others. The Department of Labor Application for Employment Certification is submitted to the local state Job Service office at the location of the intended employment.

4.3 Labor Certification Decision and Administrative Review

When a decision has been reached on the labor certification application, the Department of Labor notifies the employer in writing, with a copy to the alien.

If the labor certification is not granted, then a Notice of Findings is issued to the employer and the alien, showing the date and the specific reasons for the Notice of Findings.

4.3.1 When to file for review

The employer has thirty-five days from the date of the Notice of Findings to submit evidence to correct defects or rebut the findings. If a response is not mailed by certified mail by the thirty-fifth day, then the decision is final. The failure to file a rebuttal will be deemed a refusal to exhaust administrative remedies, which means that the employer cannot request judicial review of the adverse decision.

4.3.2 Scope of filing

Rebuttals and additional evidence may be submitted by the employer or by the alien if the employer also makes a submission. All findings not rebutted are deemed admitted.

The request for review should contain only legal argument and evidence that was in the record; new lines of argument cannot be opened on review.

4.3.3 Hearings

The certifying officer prepares an appeal file after receiving the request for review. Copies are sent to the administrative law judge and solicitor of labor in Washington, D.C., and to the employer and the alien. The employer and alien may examine the record and suggest additions. The suggestions are sent to the administrative law judge, with copies to the solicitor of labor.

An administrative law judge is designated to hear the case and direct the submission of briefs. The judge then can affirm the denial, direct that the certification be granted, remand the case to the certifying officer for further consideration or fact-finding, or order a hearing.

At a hearing, the solicitor of labor represents the Department of Labor. The administrative law judge, while able to question witnesses, is not an advocate for either party. The parties can present, examine, and cross-examine witnesses, but technical rules of evidence do not apply.

The administrative law judge decides issues of fact and law, but cannot consider any arguments that the immigration law may be invalid or unconstitutional. The judge issues a written decision, sending copies to the alien, the employer, the certifying officer, and the solicitor.

An adverse decision of the administrative law judge is subject to review by the federal courts. This should be handled by an attorney experienced in immigration cases.

4.4 Refiling After Denial

If an application for labor certification has been denied, it may be refiled six months after the denial. If the denial was solely because the wage offered was less than the prevailing wage, it may be refiled immediately. For Schedule A occupations, it may be refiled at any time.

4.5 Validity of Labor Certification

4.5.1 Duration and effective date

Once granted, a labor certification continues indefinitely. For Schedule A, it is effective as of the date stamped by the INS; for all others, it is effective as of the date the local job service office date-stamped the application. The effective date determines the priority date for a visa application.

A labor certification may be invalidated for fraud.

4.5.2 Geographic and occupational scope

For Schedule A occupations, the labor certification is valid for the occupation. It is limited in area only if the certification so specifies.

For other occupations, the labor certification is valid only for the particular job offer.

5. INELIGIBILITY FOR VISAS—EXCLUSION

5.1 Determination of Excludability

As described above, the determination of excludability is made by the U.S. consul before a visa is issued, and may be redetermined by the INS at the port of entry to the United States.

5.2 Brief List of Grounds for Exclusion

The Immigration and Naturalization Act sets out thirty-three grounds for exclusion. A partial list includes:

Medical, such as contagious disease or insanity
Pauper, likely to become a public charge
Criminal convictions
Polygamy
Prostitution
Immoral sexual acts
Attempted entry into the United States under the third or sixth preference categories without labor certification
Previous exclusion or deportation
Stowaways
Visa fraud
Failure to present valid visa and travel documents at the border
Evasion of military service
Illiteracy
National security grounds
Alien smuggling for gain
Certain foreign medical graduates (to prevent brain drain)
Nazi-directed persecution

6. APPLYING FOR U. S. CITIZENSHIP

6.1 Requirements

The process of applying for U.S. citizenship is called *naturalization*. The requirements are

— Lawful admission as a permanent resident of the United States.

— Continuous residence (not necessarily physical presence) in the United States for at least five years immediately preceding the filing of the petition for naturalization (three years for spouses of U.S. citizens).

— Physical presence within the United States for an aggregate total of at least one half of the period of residence (two and one-half years; one and one-half years for spouses of U.S. citizens).

— Residence for at least six months in the state in which petition for naturalization is filed.

— Ability to read, write, and speak ordinary English (waived for long-time residents over fifty years of age); knowledge and understanding of the fundamentals of U.S. history and government.

— Good moral character, attachment to the principles of the Constitution, and proper disposition to the good order and happiness of the United States.

— Continuous residence (not necessarily physical presence) in the United States from the date the naturalization petition was filed until actual admission to citizenship; intention to reside permanently in the United States.

6.2 Procedure

If an applicant satisfies the requirements, then he or she files an application to petition for naturalization on INS form N-400—this is preliminary to filing the actual petition. It is filed with the INS office with jurisdiction over the applicant's residence.

The naturalization petition is filed with federal court (or delegated state court) with jurisdiction over the applicant's residence. INS acts as agent of the court in evaluating the applicant's credentials.

Applicants are interviewed by the INS. They must establish that they satisfy the physical presence requirement and that they are of good moral character. The examiner will then test for English and knowledge of U.S. government history. The examiner completes the petition at the interview, and it is filed with the court together with the examiner's recommendation. The court always follows the examiner's recommendation. No waiting period is required, but the hearing is scheduled according to the court's backlog, unless expedited treatment is requested and granted. At the hearing, the applicant is sworn in and the certificate of naturalization is issued by the clerk of the court.

7. EMPLOYER RESPONSIBILITIES

Currently it is unlawful for anyone to hire, recruit, or refer for a fee an unauthorized alien or any other employee without verifying the employee's status. In an effort to combat illegal immigration, a major provision of the IRCA of 1986 imposed increased employer responsibilities and employer sanctions. (See section 8 of this chapter.) After November 6, 1986, it is unlawful to continue employment of an alien if the alien is or becomes unauthorized. These provisions also apply to independent contractors.

An employer's good-faith attempt to comply will be sufficient, and the employer may rely upon the representations as to an alien's status made by a state employment agency or job service office.

7.1 Employment Verification System

For each new employee, an employer must fill out Form I-9, under penalty of perjury, stating that he or she has

— Examined the employee's U.S. passport or foreign passport with attorney general endorsement, or one document in each of the two groups described below, and

— Validated the employee's social security number.

Form I-9 specifies which documents the employer examined. An employer may rely on documents that appear to be valid.

The first group of documents are those evidencing employment authorization, such as

— A social security account number card.

— U.S. birth certificate.

— Report of U.S. Citizen Birth Abroad.

— Form I-94 with employment authorization stamp.

The second group of documents are those establishing identity, such as

— Alien documentation.

— Driver's license or state ID with photo or with full name, date of birth, height, weight, eye color, and residence address.

— Original identification document issued by a state for any purpose (containing either a photograph or the same information as in a driver's license, above).

— If an individual resides in a state that doesn't provide for identification documents (other than a driver's license), then a U.S. Armed Forces service discharge or active or reserve duty papers.

The employee must also attest to being either a citizen, a permanent resident, or lawfully entitled to the employment by cosigning Form I-9.

The employer must comply with these provisions by noon of the day following the first day on the job. The employer must retain Form I-9 for the later of three years after hiring the employee or one year after the employee terminated employment.

The attorney general, secretary of labor and the secretary of health and human services are to jointly establish a system for validating social security numbers. Currently, employers are given three days notice before being required to present Form I-9s to an inspector.

7.2 Prohibition of Discrimination

An employer may not discriminate against applicants on the basis of national origin or status as a citizen or intending citizen. A citizen or intending citizen includes an alien who is a permanent resident, a refugee, or an asylee who completes a declaration of intent to become a citizen.

An employer is exempt from this provision if

— He has three or fewer employees.

— The 1964 Civil Rights Act, Section 703, covers him instead.

— He is complying with a government contract (for example, security provisions on defense contracts).

— English language skill is a bona fide job requirement.

Attorney's fees are recoverable by the prevailing party in any suit brought for discrimination.

This provision of the IRCA places employers in a delicate position. Employers must be careful not to hire illegal aliens, yet they are prohibited from discriminating against applicants who may *appear* to be illegal aliens. Thus, employers must consider all potential applicants and be certain to inspect the required documents of any person having been given employment. Note that applicants are required to complete Form I-9 only after having been offered employment, not when initially applying. It is a good idea to store the forms away from other personnel documents; the fewer people who have access to I-9s, the less likelihood of the documents being used to sustain a claim that the employer discriminated on the basis of age, citizenship, or national origin.[1]

8. PENALTIES

8.1 Employer Responsibilities

Under the employer's responsibilities discussed in section 7, an employer who violates the provisions is subject to civil and criminal penalties.

An employer is entitled to notice and a hearing, if accused of violating the provisions. For a first offense, employers are subject to a civil penalty of not less than $1,000 and not more than $2,000 for each unauthorized alien employee. For a repeat offense, the civil penalties range from $2,000 to $5,000 for each unauthorized alien employee. Employers who show a pattern of violations may be subject to criminal penalty of a $1,000 fine and up to six months imprisonment. Additionally, the U.S. attorney general is empowered to seek an injunction against an employer.

If the violations are merely paperwork violations, the fines drop down to $250 to $1,000 for each employee.

Hearings are to be held by an administrative law judge, with at least thirty days notice. Either party may appeal an adverse decision to the U.S. Court of Appeals within sixty days.

Civil penalties are collected by the U.S. attorney general by civil suit in federal district court.

An employer cannot require an employee to post a bond or indemnify the employer from any violations of these provisions. If an employer attempts to gain employee indemnification, the employer is subject to a civil penalty of $1,000 plus reimbursement of the indemnification or bond expenses. Presently, and until June 1, 1988, initial offenses are grounds for a warning or citation, not a penalty.

8.2 Other Penalties

Other penalties exist for

— Illegally smuggling aliens into the U.S.

[1]Marsia Manley, "Coping with the New Immigration Law," *Inc Magazine* (August 1987), 91-94.

— Misrepresenting or concealing facts.
— Re-entering the U.S. after being deported.

9. PENDING DEVELOPMENTS

Penalty provisions of the Immigration Reform and Control Act are scheduled to be phased in over an eighteen-month period, and reports are scheduled to be presented to Congress every three years to determine how successful the provisions of the act are.

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APPENDIX 1: Addresses of Government Offices

Department of Labor Regional Offices

Region	*Jurisdiction*	*Address*
I	CT, ME, MA, NH, RI, VT	Room 1707, JFK Federal Building, Government Center Boston, MA 02203
II	NY, NJ, PR	Room 3713, 1515 Broadway New York, NY 10036
III	DE, MD, PA, VA, WV, DC	P.O. Box 8796 Philadelphia, PA 19100 (street address, not for mailing purposes: 3535 Market Street)
IV	AL, FL, GA, KY, MS, NC, SC, TN	Room 405, 1371 Peachtree Street, NE Atlanta, GA 30309
V	IL, IN, MI, MN, OH, WI	230 S. Dearborn St. Chicago, IL 60604
VI	AR, LA, NM, OK, TX	Room 317, 555 Griffin Square Building Griffin & Young Sts. Dallas, TX 75202
VII	IA, KS, MO, NE	Room 1000, Fed Bldg 911 Walnut St. Kansas City, MO 64106
VIII	CO, MT, ND, SD, UT, WY	1961 Stout St. Denver, CO 80202
IX	AZ, CA, GU, HI, NV	Box 36084, Federal Office Bldg 450 Golden Gate Avenue San Francisco, CA 94102
X	AK, ID, OR, WA	Room 1145 Fed Office Bldg 909 First Avenue Seattle, WA 98174
—	VI	First National City Bank Bldg Veterans Drive St. Thomas, VI 00801

Source: 20 CFR § 656 60

Immigration and Naturalization Service District Offices

Federal Building, U.S. Courthouse
701 C Street, Room D-229
Anchorage, AL 99513
907-271-5029

E.A. Garmatz Fed Bldg
100 S. Hanover St.
Baltimore, MD 21201
301-962-2010

68 Court St.
Buffalo, NY 14202
716-846-4742

A.J. Celebrezze Fed Bldg
1240 E. 9th St., Room 1917
Cleveland, OH 44199
216-522-4770

1787 Fed Office Bldg
1961 Stout St.
Denver, CO 80202
303-837-3525

343 U.S. Courthouse
P.O. Box 9398
El Paso, TX 79984
915-543-7600/7601

900 Asylum Avenue
Hartford, CT 06105
203-244-2659/2699

P.O. Box 461
595 Ala Moana Blvd.
Honolulu, Hawaii 96808
808-546-8979/8980

324 E. Eleventh St.
Suite 1100
Kansas City, Missouri 64106
816-374-3421

Richard B. Russell Federal Bldg.
75 Spring St., SW, Room 1403
Atlanta, GA 30303
404-221-5158

JFK Fed Bldg
Government Center
Boston, MA 02203
617-223-2343/2344

Dirksen Fed Office Bldg
219 S. Dearborn St.
Chicago, IL 60604
312-353-7334

Room 6A21, Fed Bldg
1100 Commerce St.
Dallas, TX 75242
214-767-0514

Fed Bldg
333 Mt Elliot St.
Detroit, Mich 48207
313-226-3240

2102 Teege Road
Harlingen, TX 78550
512-425-7333

Federal Bldg
301 S. Park, Room 512
Drawer, 10036
Helena, Montana 59626
406-449-5288

Fed Bldg
2627 Caroline
Houston, TX 77004
713-226-4251

300 N. Los Angeles St.
Los Angeles, CA 90012
213-688-2780

155 S. Miami Ave.
Miami, FL 33130
305-350-5741

Postal Services Bldg
701 Loyola Ave.
New Orleans, LA 70113
504-589-6533

Fed Office Bldg, Room 1008
106 S. 15th St.
Omaha, NE 68102
402-221-4651

Federal Bldg
230 N. 1st Ave.
Phoenix, AZ 85025
605-261-3122/3114/3115

Fed Office Bldg
511 N.W. Broadway
Portland, Oregon 97209
503-221-2271

180 E. Kellogg Blvd.
927 New Post Office Bldg
St. Paul, MN 55101
612-725-7108

880 Front St.
San Diego, CA 92188
714-293-6250

G.P.O. 5068
San Juan, PR 00936
809-753-4329/4379/4380

25 E. Street, N.W.
Washington, DC 20538
202-724-0137/0138

Fed Bldg
970 Broad St.
Newark, NJ 07102
201-645-3350

26 Fed Plaza
New York, NY 10007
212-349-8735

Room 1321 U.S. Courthouse
Independence Mall West
601 Market St.
Philadelphia, PA 19106
215-597-7305

76 Pearl St.
Portland, ME 04112
207-780-3352

Fed Bldg
P.O. Box 328
St. Slbans, VT 05478
802-524-6742/6743

U.S. Fed Bldg
727 E. Durango, Suite A301
San Antonio, TX 78206
512-229-6350

Appraisers Bldg
630 Sansome St.
San Francisco, CA 94111
415-556-2070

815 Airport Way South
Seattle, WA 98134
206-442-5950

Source: Wernick, Allan H., *The Guide to Immigration Counseling* (New York: Center for Immigrant Rights, 1985).

APPENDIX 2: Visa Symbols

Visa Symbol	*Class*
A-1	Ambassador, public minister, career diplomat or consular officer, and members of immediate family
A-2	Other foreign government official or employee, and members of immediate family
A-3	Attendant, servant, or personal employee of A-1 and A-2 classes, and members of immediate family
B-1	Temporary visitor for business
B-2	Temporary visitor for pleasure
C-1	Alien in transit
C-2	Alien in transit to United Nations Headquarters district under §11 (3), (4), or (5) of the Headquarters Agreement
C-3	Foreign government official, members of immediate family, attendant, servant, or personal employee, in transit
D	Crewman (seaman or airman)
E-1	Treaty trader, spouse and children
E-2	Treaty investor, spouse and children
F-1	Student
F-2	Spouse or child of student
G-1	Principal resident representative of recognized foreign member government to international organization, his staff, and member of immediate family
G-2	Other representative of recognized foreign member government to international organization, and members of immediate family
G-3	Representative of nonrecognized or nonmember foreign government to international organization, and members of immediate family
G-4	International organization officer or employee, and members of immediate family
G-5	Attendant, servant, or personal employee of G-1, G- 2, G-3, and G-4 classes, and members of immediate family
H-1	Temporary worker of distinguished merit and ability
H-2	Temporary worker performing services unavailable in the United States
H-2A	Agricultural worker
H-3	Trainee
H-4	Spouse or child of alien classified H-1, H-2, or H-3
I	Representative of foreign information media, spouse, and children
J-1	Exchange visitor
J-2	Spouse or child of exchange visitor
K-1	Fiance(e) of U.S. citizen
K-2	Minor child of fiance(e) of U.S. citizen
L-1	Intracompany transferee (executive, managerial, and spe-

	cialized personnel continuing employment with international firm or corporation)
L-2	Spouse or minor child of alien classified L-1
M-1	Vocational student
M-2	Spouse or child of student
NATO-1	Principal permanent representative of member state to NATO (including any of its subsidiary bodies) resident in the United States and resident members of his official staff; Secretary General, Deputy

Source: Wernick, Allan H., *The Guide to Immigration Counseling*, (New York, Center for Immigrant Rights, 1985), appendix B; 8 U.S.C. 1101(a)(15), PL 99-603.

APPENDIX 3: INS Form I-9

EMPLOYMENT ELIGIBILITY VERIFICATION (Form I-9)

1 EMPLOYEE INFORMATION AND VERIFICATION: (To be completed and signed by employee.)

Name (Print or Type) Last	First	Middle	Birth Name
Address: Street Name and Number	City	State	ZIP Code
Date of Birth (Month/Day/Year)		Social Security Number	

I attest, under penalty of perjury, that I am (check a box):

☐ 1 A citizen or national of the United States.
☐ 2. An alien lawfully admitted for permanent residence (Alien Number A ________)
☐ 3. An alien authorized by the Immigration and Naturalization Service to work in the United States (Alien Number A ________ or Admission Number ________, expiration of employment authorization, if any ________)

I attest, under penalty of perjury, the documents that I have presented as evidence of identity and employment eligibility are genuine and relate to me. I am aware that federal law provides for imprisonment and/or fine for any false statements or use of false documents in connection with this certificate.

Signature	Date (Month/Day/Year)

PREPARER/TRANSLATOR CERTIFICATION (To be completed if prepared by person other than the employee). I attest, under penalty of perjury, that the above was prepared by me at the request of the named individual and is based on all information of which I have any knowledge.

Signature	Name (Print or Type)		
Address (Street Name and Number)	City	State	Zip Code

2 EMPLOYER REVIEW AND VERIFICATION: (To be completed and signed by employer.)

Instructions:
Examine one document from List A and check the appropriate box, ***OR*** examine one document from List B ***and*** one from List C and check the appropriate boxes. Provide the ***Document Identification Number*** and ***Expiration Date*** for the document checked.

List A Documents that Establish Identity and Employment Eligibility	List B Documents that Establish Identity	and	List C Documents that Establish Employment Eligibility
☐ 1 United States Passport ☐ 2. Certificate of United States Citizenship ☐ 3. Certificate of Naturalization ☐ 4. Unexpired foreign passport with attached Employment Authorization ☐ 5. Alien Registration Card with photograph	☐ 1 A State-issued driver's license or a State-issued I.D. card with a photograph, or information, including name, sex, date of birth, height, weight, and color of eyes. (Specify State) ________) ☐ 2 U.S. Military Card ☐ 3. Other (Specify document and issuing authority) ________		☐ 1 Original Social Security Number Card (other than a card stating it is not valid for employment) ☐ 2 A birth certificate issued by State, county, or municipal authority bearing a seal or other certification ☐ 3 Unexpired INS Employment Authorization Specify form # ________
Document Identification # ________ ***Expiration Date (if any)*** ________	***Document Identification*** # ________ ***Expiration Date (if any)*** ________		***Document Identification*** # ________ ***Expiration Date (if any)*** ________

CERTIFICATION: I attest, under penalty of perjury, that I have examined the documents presented by the above individual, that they appear to be genuine and to relate to the individual named, and that the individual, to the best of my knowledge, is eligible to work in the United States.

Signature	Name (Print or Type)	Title
Employer Name	Address	Date

Form I-9 (05/07/87)
OMB No. 1115-0136

U.S. Department of Justice
Immigration and Naturalization Service

INDEX

All references in this index are to the chapter title and chapter section numbers. The following is a key to abbreviated references used in the index.

Chapter	Index Abbreviation
Employment Regulations	EMP
Workers' Compensation	WORK
Unemployment Insurance	UI
Employee Retirement & Deferred Compensation Plans	RET
Social Security	SS
Hiring Foreign Nationals	HFN