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*A Publication of the
Employer Advisory
Council of Orange
County in partnership
with the Employment
Development Department,
State of California*

Health Care Reform Bill Signed Into Law Imposes Significant Financial Responsibility on Employers

President Barack Obama recently signed into law the Patient Protection and Affordable Care Act (PPACA), the first of two interrelated bills that together will embody Congress's comprehensive health care reform legislation. The second piece of the legislative package is H.R. 4872, entitled the "Health Care and Education Affordability Reconciliation Act of 2010." At press time, this bill has not yet been signed into law.

Employers will be affected most directly by the health coverage provisions of Titles I and IX of the Act. Those provisions will transform the current model for employer-sponsored health coverage, under which an employer generally can choose whether, to what extent, and on what terms it will provide health coverage for some or all of its employees. In place of the current model, the Act will place an obligation on most individuals to obtain coverage for themselves and their dependents beginning in 2014. That same year, the Act also will begin to impose

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**Need Qualified Employees?
Recruitment is Easy at One or
More Upcoming Job Fairs**

Your local Employment Development Department offices are presenting a number of job fairs over the next month. Co-sponsored by the EAC, the events are an easy way to meet and interview large numbers of pre-screened job applicants.

In April there will be two Summer Youth Job Fairs. Both will take place from 9:30 a.m. to 12:30 p.m. on Saturday, April 24. The locations are (1) The Block at Orange, 20 City Blvd., Orange, CA 92868 and (2) the La Habra Community Center, 101 W. La Habra Blvd., La Habra, CA 90631. This is a great opportunity to interview young people seeking both summer and full time employment. For more information on these events, please call 714-565-2665.

One of the highlight events of each year is the "Honor a Hero, Hire a Vet" job fair. This event is primarily a job and resource fair for veterans, national guard, and reservists returning from active duty, but is open to all job seekers. The event is scheduled on Wednesday, May 26 from 9:00 a.m. to 1:00 p.m. at the Costa Mesa Hilton Hotel, 3050 Bristol Street, Costa Mesa, CA 92626. Please call 714-687-4816 for more details on this great event.



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President's Message . . .

by Stewart Lerner

We could not be happier about the results of our first quarter activities. It was great that our January, February and March workshop speakers each received top-level evaluations from those of you in attendance. It is always gratifying when your ratings match our faith in the scheduled presenters.

In February, we scheduled our first program in our new location in South County. Based on your evaluations, this too was a hit. Not unexpectedly, there were a few minor adjustments that will need to be made but it looks like we may have a winner. Of course, we will carefully monitor your April ratings to ensure that everything meets your standards.

The second quarter of the year will be a very busy one for your EAC. As we go to press, we have just completed our April programs on Sexual Harassment with one of our largest crowds of the year in attendance at Garden Grove. Keith Watts, our speaker, in addition to being a great attorney, is a former actor. With that background, he was able to provide an entertaining as well as an informative program. Keith also signed certificates of completion for all of those in attendance. See related article on Page 3.

In May, Anna Winningham will journey down from Thousand Oaks to present a special program on the growing problem of Workplace Violence. Her presentation will include such topics as threat assessment and how to handle at-risk terminations. I had the pleasure of hearing Anna's highly-rated presentation at the statewide CEAC conference last year. It will open your eyes!

Also, during the second quarter, we will be sponsoring a number of Job Fairs with our EDD partners. These events provide a great opportunity for our employer members to interview large numbers of potential employees in a controlled and comfortable atmosphere. I urge you to consider attending if you have hiring needs. Please review the article earlier in this newsletter for contact our office for more information.

Finally, in June we will be holding our annual planning session where we will be developing our programs and activities for 2011. It is never too early to begin planning! Let me close my comments by once again thanking each of you for your continued support of our organization and our programs.

***April Workshop Speaker a HUGE Hit With Members!
Keith Watts certified a total of 165 attendees at the
Sexual Harassment Training workshop!!***



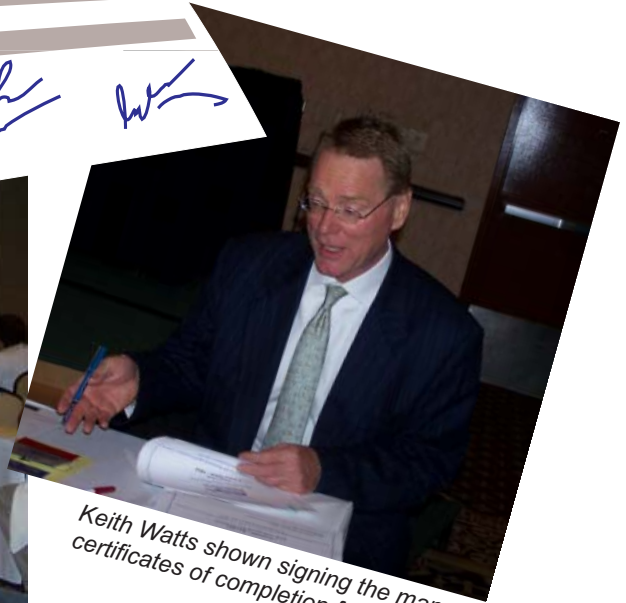
A very serious Stewart Lerner introducing the speaker Keith Watts.



Our speaker Keith Watts making a point to the many attendees at this workshop.



The large number of attendees paid rapt attention to Keith Watts' message.



Keith Watts shown signing the many certificates of completion for attendees.

President Obama Signs Jobs Bill Into Law

On March 18, 2010, President Barack Obama signed into law the Hiring Incentives to Restore Employment (HIRE) Act. The bill contains approximately \$17.6 billion in tax credits to stimulate employment and contributes about \$20 billion toward highway and transit infrastructure programs. The President stated that while the jobs bill was “absolutely necessary,” it was “by no means enough and that [t]here’s a lot more that we’re going to need to do to spur hiring in the private sector and bring about full economic recovery.”

One of the more important provisions for business is the tax credit for hiring unemployed workers. In particular, HIRE exempts companies from paying the 6.2% Social Security payroll tax through December 31, 2010, for certain new employees. To qualify, the new employee must begin working after February 3, 2010, and before January 1, 2011, and certify that they have not worked more than 40 hours during the 60-day period before employment begins. Also, this new employee may not replace an existing employee of the employer unless the other employee’s employment terminated voluntarily or for cause.

In addition, companies would receive a \$1,000 tax credit

on their 2011 tax return for each new employee who commences employment during the year and is employed for at least one year. The HIRE Act also includes a provision that will reimburse the Social Security Trust Fund from the general fund for the lost payroll taxes it will incur from the



payroll tax exemption. Estimates are that these tax credits could stimulate the creation of up to 300,000 jobs.

Another provision of the HIRE Act that is especially important to small business is the increase in the “expensing” tax allowance. Small businesses will be able to write off up to \$250,000 of certain capital assets and equipment instead of depreciating them over time.

Approximately \$77.2 billion is provided in the HIRE Act for the surface transportation program last authorized by the 2009 transportation legislation. The HIRE Act will continue funding for a variety of federal-aid highway, transportation and surface transportation construction projects through the end of this calendar year.

The HIRE Act also generates revenue to offset the various investments or expenditures. One key revenue source would be a limitation on the ability of multinational corporations to shift assets among foreign institutions to minimize withholding tax.



IRA Rules That Employer-Provided Clothing is Not Wages Under Some Circumstances

by

William Hays Weissman, Esq., Littler Mendelson

In Private Letter Ruling 2010-05014, the Internal Revenue Service (IRS) held that an employer could exclude the value of employer-provided clothing and related accessories from its employees’ wages as a *de minimis* fringe benefit. This Ruling provides some clarity on when employer-provided clothing can be excluded from

an employee’s wages, but employers should be careful to limit this Ruling’s holding to its somewhat particular facts.

Background Facts

The ruling was requested by a political subdivision of a

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Employer-Provided Clothing . . . from Page 4

state that is divided into numerous departments. Many of the departments provide their employees work-related articles of clothing and accessories, including t-shirts, polo shirts, sweaters, jackets, swimsuits, socks, sweatshirts, coats, pants, jeans, shorts, gloves, hats, fanny packs, belts, clip-on ties, and equipment bags. Most of the items bear the taxpayer's logo, or other information identifying the individual as an employee of the taxpayer. Employees are required to wear the clothing items while performing services for the taxpayer. Items are ordered from a vendor under a master contract. The pricing may vary considerably from item to item, and the contracts rarely include specific prices. For example, a medium t-shirt may have a different cost than a large t-shirt, or two medium t-shirts made of different grade material may have different costs. Also, due to escalation clauses, the price for the same size t-shirt may vary from year to year.

Items are usually distributed when an employee is hired, and may be replaced on an as needed basis. Also, the number of items received vary based on several factors, such as whether the employee is full-time or part-time and the kinds of services being performed.

The Ruling

Under Internal Revenue Code rules, any compensation, whether cash or property, provided to an employee for services is treated as wages subject to employment taxes unless there is a specific exclusion. One such exclusion is for *de minimis fringe benefits*. A *de minimis fringe benefit* is any property or service the value of which is so small (after taking into account the frequency with which the employer provides similar fringes to other employees) as to make accounting for it unreasonable or administratively impracticable. The Ruling addressed all three criteria necessary to establish a *de minimis* fringe benefit: (1) the

value of the benefits; (2) the frequency with which the taxpayer distributed the benefits; and (3) whether it was administratively impracticable to require the taxpayer to account for the benefits.

Items Deemed to Be of Low Value

With respect to the value of the items, the Ruling states: "The items identified by Taxpayer are of low value. Using the cost of the items as an approximation of their values, it is reasonable to conclude that the items listed in



Taxpayer's ruling request are *de minimis* fringes if Taxpayer can also establish both that the frequency with which the items were distributed does not preclude such a finding, and that it would be administratively impracticable to account for each item's value."

Items Not Distributed Too Frequently

Turning next to the issue of distribution frequency, the IRS noted that items are usually distributed upon hire and then only on an as-needed basis. There were also policies about the maximum number of items that could be received. "We do not consider the provision of the items once, or perhaps twice, annually as so frequent that, given the low value of

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Finally, there is some good news on the economic front! According to the latest Labor Department report, the U.S. economy added 162,000 jobs in March, the most in three years.

However, the boost was not enough to lower the unemployment rate which remained at 9.7%. According to analysts, the economy needs to add about 125,000 jobs a month just to keep pace with population growth. Many more than that will be needed to lower the jobless rate.

Heidi Shierholz of the Economic Policy Institute in Washington added another sobering note saying "While (the report) is very good news, its not a signal that the private sector is poised to create the kinds of numbers of jobs to put many people back to work."

Still, it is a start!

In a move that may impact employers in years to come, President Obama in late March appointed four new members to the Equal Employment Opportunity Commission. These appointments will restore the EEOC to full capacity and will provide sufficient votes to enact a number of existing priorities. Most important may be the issuance of final regulations interpreting the Americans with Disabilities Act Amendments Act which was passed in 2008. It is expected these regulations will expand the ADA significantly.

Other priorities of the Commission may allow it to target

"systemic discrimination" by transforming individual cases into large class actions. The EEOC is also launching a five-year program known as its E-RACE initiative. This will target criteria that the agency believes has a disparate impact on people of color, including hiring tests, credit and background checks, and arrest and conviction records. Stay tuned for more on these developments.

Lerner Lines

by
Stewart Lerner
Lerner & Associates



In more local news, it appears that the Employment Development Department (EDD) may finally be doing some significant modernization. EDD is streamlining its antiquated payment system by introducing electronic debit cards to replace printed checks.

The hope is to begin using the new technology in September. If successful, California will join 43 other states that have already upgraded to plastic. Some critics fear, however, that putting this large a system into place is no small feat and might not go smoothly.

Proponents believe that providing payments electronically is a safer, faster way to get benefit payments to claimants while saving the cost of printing and mailing paper warrants. Using debit cards would avoid problems caused by late, lost or stolen checks as well as the steep fees charged by some commercial check-cashing businesses. As an added bonus, customers could use the debit cards to withdraw cash from banks and ATMs, as well as to make purchases at stores that honor debit and credit cards. Sounds good to this writer!



Employer-Provided Clothing . . . from Page 5

each item, the provision could not properly be characterized as *de minimis*." Nonetheless, the IRS also pointed out that the "relevant inquiry for purposes of determining employer-measured frequency is not the frequency with which each individual employee actually received the benefits, but the frequency with which all employees collectively received the benefits."

The IRS also addressed the issue of when frequency is determined by employer-based criteria or employee-

based criteria. The IRS pointed out that an employer cannot tailor its procedures to make accounting for *de minimis* fringe benefits administratively difficult for the purpose of achieving *de minimis* fringe benefit treatment.

Nonetheless, the IRS found that it was appropriate in this case to determine frequency by an employer-based criteria. Specifically, the IRS found that under the taxpayer's policies it would have to require each

a financial responsibility on employers to subsidize the coverage selected by most employees.

Short Term Effects

Before turning to the substantial changes that will begin in 2014, it is worth noting a few of the “early deliverables” under the Act, beginning with the one that arguably had the greatest popular appeal. Within 90 days of enactment, the federal government will establish a temporary high risk pool that will insure individuals with pre-existing conditions. That pool will continue through 2014, when a ban on pre-existing condition exclusions goes into effect.

Effective for plan years beginning on or after September 22, 2010, lifetime limits on the dollar value of coverage are prohibited, coverage of unmarried dependent children under a plan maintained by a parent’s employer is extended to age 26, and “first dollar coverage” (i.e., no cost sharing) for certain evidence-based preventative care is required.

The Individual Mandate

Beginning in 2014, the Act will add a new provision to the Internal Revenue Code that imposes a penalty tax on an “applicable individual” who does not maintain “minimum essential coverage” for himself or herself and for any dependent who is an “applicable individual” during any month after 2013. The amount of the penalty is determined by a complex formula that takes into account factors such as household income and the national average premium for coverage under “bronze plans” offered by state or regional insurance Exchanges. The maximum penalty tax will be phased in over three years, reaching \$2,250 in 2016, and will be indexed thereafter.

Certain “applicable individuals” are exempt from the penalty tax, including (a) individuals whose household income falls below the federal poverty line; and (b) individuals whose share of premiums or employee contributions would exceed eight percent of their household income. These exemptions apply only after taking into account a means-based tax credit that will be available under the Act.

The Employer Mandate

The Act also adds a provision to the Internal Revenue Code that imposes a monthly assessment on certain employers that do not offer an employer-sponsored health plan that meets federally-determined standards for health coverage to their full-time employees, or that offer such coverage but whose plans have a waiting period of 60 or more days. The penalty for an extended waiting period is \$600 per full-time employee to whom the waiting period applies.

The penalty for not offering all full-time employees an opportunity to enroll in “minimum essential coverage” under an eligible employer-sponsored plan can be far greater: if even one full-time employee obtains such coverage elsewhere and is eligible for a tax credit or cost-sharing reduction, the monthly assessment on the employer is a multiple of all the employer’s full-time employees during the month.

Finally, an assessment also applies if an employer subject to the mandate fails to subsidize a sufficient portion of the employee’s cost for “minimum essential coverage” to prevent the employee from qualifying for a tax credit or cost-sharing reduction. This “under-subsidization” tax also is based on the employer’s total number of full-time employees, even if only one full-time employee qualified for the tax credit or cost-sharing.

The mandate applies only to an “applicable large employer,” which generally means an organization that employed on average at least 50 full-time employees on business days during the preceding calendar year. However, beginning in 2013, employers with as few as five full-time employees can be subject to the employer mandate if substantially all their revenue is derived from the construction industry and their annual gross receipts exceed \$250,000.

A series of complex rules governs the calculation of an employer’s average number of full-time employees. Also, the term “full-time employee” is defined as a worker employed on average for at least 30 “hours of service” per week, using a new definition of “hour of service” to be promulgated by the Secretaries of the U.S. Department of Health and Human Services (HHS) and the U.S.

Department of Labor – a definition that may not precisely match the definition of an “hour of service” for qualified retirement plan purposes.

Health Care Exchanges

The most fundamental changes caused by the Act will result from the creation of 50 or more geographically-based marketplaces, referred to as “Exchanges,” where standardized insurance packages can be purchased on what are expected to be favorable terms. The territory of many Exchanges will coincide with state or municipal boundaries, although multiple states can operate a single Exchange. In addition, the Act provides for multi-state health plans to be offered by these Exchanges. The multi-state plans will be established by the Director of the Office of Personnel Management by contracts with for-profit and not-for-profit insurers.

The Act creates incentives for employers and individual consumers to prefer Exchange-provided coverage to other coverage alternatives. The Act also bars an insurer from offering coverage on an Exchange unless the insurer’s policies adhere to standards established under the Act or in regulations that will be adopted by HHS under the Act. In addition, insurers will be required to make periodic disclosures relating to rating, claims processing, and other matters. Each Exchange will have additional protections from competition that could allow it to become virtually the only viable marketplace for health care coverage within its territory.

Excise Tax on “Cadillac” Health Plans

Beginning in 2013, coverage under group health plans that departs upwards from the basic federal model will become subject to a non-deductible excise tax. The 40 percent excise tax will apply to the amount by which the cost of the coverage provided to an employee exceeds predetermined limits. In the first year the excise tax applies, the annual limits are \$8,500 for self-only coverage and \$23,000 for any other coverage. (The limits will be subject to cost-of-living adjustments thereafter.) Any

cost above those limits will be taxed at 40 percent, even if the employee pays 100 percent of the entire cost of the coverage.

The Cadillac health plan tax is expected to discourage employers from offering any group health plan that is not an “off the rack” Exchange-available insured plan.

H.R. 4872 and Its Impact

H.R. 4872 will have several important effects on the employer-related provisions of the PPACA. It will extend the increase to age 26 for coverage of non-dependent children to all group health plans. Similarly, it eliminates an exception in the PPACA for “grandfathered plans” that exempts them from the prohibitions on lifetime limits, the prohibition on pre-existing condition exclusions, and other group market reforms.

H.R. 4872 also will postpone the excise tax on Cadillac group health plans until 2018, and raise the annual limits on which the tax will be based. In addition, it will allow for some relief in the case of an employer whose employee population deviates significantly from a national risk pool in a way that makes the employee group more costly to cover. It also reduces the penalty otherwise applicable to small employers that violate the employer mandate under the Act by permitting the penalty calculation to be based on the actual number of the employer’s full-time employees minus 30. By contrast, H.R. 4872 will increase one significant limitation on the amount of the penalty tax due from an “applicable individual” who does not satisfy the individual mandate to be insured.

Conclusion

Although almost all of the most far-reaching provisions of the Act will not become effective until after 2013, Ogletree Deakins shareholder Tom Christina notes, the process of planning for compliance must begin much earlier. This bill was signed into law on March 30, 2010.

department to track the number of items that each employee received, maintain records for each employee, and routinely transmit such records to various fiscal officers. Further, the IRS found that: (1) many departments, particularly those that provide the items on an “as-needed” basis, do not distribute items at regular intervals; (2) many items are provided to volunteers, a population whose receipt of employer-provided items is inherently difficult to track; and (3) not all employees opt to receive all items that they are entitled to receive under departmental policies.

Administratively Impractical to Account for Items

The IRS noted that while the determination of administrative impracticability is a facts and circumstances test, “one objective guidepost exists where the administrative costs associated with determining the value of the benefit and accounting for it may be more expensive than providing the benefit.” Here, the IRS found that, based on objective data, the taxpayer would incur substantial administrative costs to account for the fair market value of each item. Specifically, the IRS found that the vendor does not provide detailed invoices, nor can it do so at this time. Further, given the variables, such as the escalation clauses and differences in sizes and materials, it would be difficult for the taxpayer to determine cost for the items. Also, because the items have the taxpayer’s logo, their fair market value might not be readily ascertainable.

In addition, the IRS found that the taxpayer would incur substantial costs to maintain records of the fair market value. “Its necessarily large and bureaucratic structure would, however, make this process costly. Taxpayer has determined that this tracking process would require a storeroom worker to complete a form every time an employee received an item. This form would have to identify the employee, the item received, the date received, and the item’s fair market value. Storerooms would have to maintain these records, and routinely (which Taxpayer defines as most likely weekly) prepare reports and transmit copies of the records to their department’s fiscal officer.” The IRS went on to note that, while these costs result in part from the taxpayer’s large and decentralized structure, “it is notable for the purposes of a *de minimis* fringe

analysis that there is no indication that Taxpayer designed this system with an intent to make it administratively impracticable to track the items’ values. Rather, the size and nature of Taxpayer’s operations necessitates such an administrative structure.”

Therefore, the IRS held that such clothing items were *de minimis* fringe benefits and excluded from an employee’s wages.

Words of Caution For Employers

Before employers assume that any clothing they provide to employees is no longer taxable as a *de minimis* fringe benefit under this Ruling, they should carefully consider the specific facts of this Ruling. There are two facts in particular that appear critical to the IRS’s analysis. First, the taxpayer was a large and decentralized entity, which made accounting for items administratively impractical. Second, the nature of the vendor contract, with its escalation clauses and inability to articulate standard pricing clearly, was an important factor in the IRS’s determination that accounting for the costs or fair market value was administratively burdensome.

Employers that do not have the same kind of large decentralized structure, such that accounting for items would not be so burdensome, likely cannot establish the same criteria as the taxpayer in this Ruling. Further, employers that can clearly track the costs of items purchased, such as from a catalog with specific pricing, also likely cannot meet the criteria that the taxpayer in the Ruling was able to establish. It is unlikely that this Ruling will be applicable to other employers in the absence of these or similar facts.

Nonetheless, if after careful consideration, an employer does not believe it can meet the administrative burdensome criteria, it may still treat employer-provided clothing as a *de minimis* fringe benefit if the value is low, such as \$25 (and probably not more than about \$50), and the items are infrequently provided, such as once a year at a holiday party. However, employers should always remember that most items provided to employees are treated as wages unless they can find a specific exclusion, which should be narrowly construed.

E-Z FORM 2010 Workshops

General Workshops

5 Per Year • 1 Location per Workshop

The General Workshops are open to all members, nonmembers and guests. They are normally held on the third Thursday of each **ODD** month at the Hyatt Regency, 11999 Harbor Blvd, Garden Grove, CA. The only exceptions are July and December, when no workshops are held. Reservations can be made in advance, at a discounted rate, or for each specific workshop individually.

May 20 – Workplace Violence

September 16 – Wage & Hour Issues

November 18 – Hot Tips from the HR Hotline

Questions?

Please call Barbara Bivens at the EAC office at 714-846-2510 or email info@eacorangelcounty.com

Certificate Workshops

5 Per Year • 2 Locations per Workshop

June 17 & 22 – “Hiring & Firing” Training for Supervisors

August 19 & 24 – Web Abuse & Privacy Issues in Workplace

October 21 & 26 – Workers’ Compensation Updates

Please note that when there are two dates, this indicates the same workshop in two different locations.



These programs have been approved for 2.75 recertification credit hours through the HR Certification Institute. For more information about certification or recertification, please visit the HR Certification Institute home page at www.hrci.org. The use of this seal is not an endorsement by HRCI of the quality of the program. It means that this program has met HRCI's criteria to be pre-approved for recertification credit.

Registration Form

Location: Please check date and location on above.
Times: 7:15 to 8:00 am: check-in and breakfast • 8:00 to 11:30 am: Workshop with a 15-minute break
Costs: \$65 per workshop per person; for non-members \$85 per workshop per person

Registrant Name _____

Company _____

Contact Phone _____ **Contact Email** _____

Pay by Check: EAC-OC, 16033 Bolsa Chica Rd. #104-615, Huntington Beach, CA 92649

Pay by FAX: 714-844-4779

Pay by Email: info@eacorangelcounty.com

Credit Card Information: _____

Name on Card _____ Authorized Signature _____

Credit Card # _____ Exp _____ / _____ Security # _____

Billing Zip Code _____



AN INVITATION TO JOIN EAC-OC

The Employer's Cost-effective Approach to Business and Human Resource Solutions

- A hotline service for answers to employer-employee questions staffed by a labor/employment attorney. Monthly frequently asked Q & A are posted on the EAC website "Members Only"
- A quarterly newsletter, the *Advisor*, plus emailed "Alerts" with current, pertinent information
- Member discount on workshop fees – \$85 per person, discounted for members to \$65 per person
- Forum to network with other professionals in the human resources field
- Website with current information, plus a "Members Only" section with more resources
- Annual updates of forms and policies to all renewing members

The Employer Advisory Council of Orange County, Inc. is a non-profit corporation whose membership is comprised of approximately 500 companies in the Orange County area. EAC is a partner with the Employment Development Department.

PURPOSE

- Employer education and training on topics such as:
 - o Employment Trends
 - o Labor Law
 - o Legislation
 - o Workers' Compensation
- To help employers stay in compliance with the law through the Management Hotline
- To act as advisors to the Employment Development Department and help promote services they provide to the employer

MEMBERSHIP APPLICATION

You may also sign up online at www.eacorangelcounty.com

Complete this form and fax it to 714.844-4779 OR email to info@eacorangelcounty.com OR just call the Association Office 714.846.2510. EAC-OC accepts cash, check as well as Visa, MasterCard and American Express. EAC-OC, 16033 Bolsa Chica Street #104-615, Huntington Beach, CA 92649.

Company _____

Contact Name _____ Title _____

Street _____ City _____ Zip _____

Phone (____) _____ Email: _____ @ _____ Fax (____) _____

Number of employees _____ Industry _____ # of years in business _____

Amt: \$95.00 Method of payment Check enclosed MasterCard Visa America Express

Dues are paid annually in January. Your second year dues will be pro-rated based on the month you join and you will receive an invoice in November so you can pay either this year or next year. Please keep EAC in mind when you are budgeting your educational expenses. It's a good deal!!

Name on Card _____ Card # _____

Expiration date _____ Last 3 numbers on back of card _____ #4 numbers AX _____

Card Billing Address _____

City _____ State _____ Zip _____

Signature _____

Your Company is the Member. You may add up to three people from your company that you would like EAC to contact with meeting information. Please add their names, titles and emails to this application.

The Ninth Circuit Clears the Way for Tip-Pooling Arrangements

by

Laurent R. G. Badous, Esq. and Jennifer L. Mora, Esq. Littler Mendelson

Hospitality and tourism employers should greet news of a favorable Ninth Circuit Court of Appeals decision with joy and a big sigh of relief. In *Cumbie v. Woody Woo, Inc.*, No. 08-35718 (Feb. 23, 2010), the court confirmed that the Fair Labor Standards Act (FLSA) allows employers that do not take a tip credit against the federal minimum wage to pool tips and allow *all* hourly employees – not just those who have in-person interaction with guests – to receive a portion of the “tip pool.” The opinion brings clarity (and much needed legal support) in an area where confusion as to the rule of law and expensive litigation had caused uncertainty and reticence.

The Ninth Circuit’s holding confirms that employers who pay employees without taking a tip credit against the federal minimum wage can implement a tip-sharing agreement to allow tips to be divided among all hourly employees working in the establishment even if they do not interact personally with guests. At a time when the tourism and hospitality industry is feeling the pressure of razor-thin profit margins in a down economy, the court’s approval of greater flexibility in distributing proceeds of gratuities should be a welcome development.

Café Requires Its Servers to Contribute Their Tips to a Tip Pool

In *Cumbie*, the plaintiff worked as a waitress at Vita Café in Portland, Oregon, operated by Woody Woo, Inc. Vita Café paid its servers at or above Oregon’s minimum wage, which at the time was \$2.10 more than the minimum wage under the FLSA. In addition, Vita Café paid to the servers a portion of their daily tips. Although Vita Café also employed kitchen staff, such as dishwashers and cooks, the servers were the only employees who worked directly with customers and customarily received tips. Vita Café required its servers to contribute their tips to a “tip pool,” which was then distributed to all employees. Between 55% and 70% of the tips were paid to the kitchen staff, and the

remaining amount (30% to 45%) was paid to the servers in proportion to their hours worked. Vita Café did not use any of the tips to offset the employees’ minimum wage rate. The plaintiff ultimately filed a putative collective and class action against Vita Café alleging that its tip-pooling arrangement violated the minimum wage provisions of the FLSA. The lawsuit quickly landed on the Ninth Circuit’s docket after the Oregon District Court dismissed the plaintiff’s case.

Ninth Circuit Holds that Tip-Pooling Arrangements Can Include Employees Who Do Not Customarily Receive Tips

Quoting from a 1942 United States Supreme Court opinion, the Ninth Circuit panel began its legal analysis by stating that: “In businesses where tipping is customary, the tips, *in the absence of an explicit contrary understanding*, belong to the recipient. Where, however, [such] an arrangement is made ... , *in the absence of statutory interference, no reason is perceived for its invalidity.*” Despite this, employers in the hospitality industry have struggled for many years over the interplay between tip-pooling arrangements and the ability to take a “tip credit” against the minimum wage. With its decision in *Cumbie*, the Ninth Circuit becomes the first appellate court to weigh in on the ongoing debate about the validity of tip-sharing arrangements in the absence of a tip credit.

The Concept of “Tip Credit”

The FLSA’s definition of *wage* in section 203(m) recognizes that, in some situations, employers of “tipped employees” may include part of the employees’ tips to offset the employer’s obligation to pay the minimum wage. The FLSA requires employers to pay a tipped employee an amount equal to a cash wage of at least \$2.13 per hour and to ensure that the employee receives an additional amount in tips for every hour worked equal to the federal minimum wage minus the cash wage. The difference between the



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applicable minimum wage (currently \$7.25 under federal law but higher in many states) and the cash wage is referred to as the “tip credit.”

Section 203m of the FLSA provides that the employer may not take a tip credit unless the employer informs employees of the tip-credit provisions set forth in the FLSA and allows the employee to retain all tips earned, unless the employee participates in a tip pool **with other customarily tipped employees**. Although the FLSA permits tip credits, many Western states within the Ninth Circuit (Alaska, California, Montana, Nevada, Oregon and Washington) do not allow employers to apply tips toward an employee’s minimum wage. Other states allow a tip credit against the minimum wage but set the maximum amount higher than under federal regulations (for instance, Arizona caps the amount of tip credit at \$3.00).

Analysis of the Interplay Between Pooling of Tips and Tip Credit

The plaintiff claimed that section 203(m) required Vita Café to pay her all of the tips that she generated and that Vita Café violated the provision because the restaurant distributed a portion of her tips to other employees (the back-of-the-house staff) who do not “customarily” receive tips. According to the plaintiff, Vita Café was obligated not only to pay servers their minimum wage, but also to allow the servers to keep all of the tips they generated.

In rejecting this argument, the Ninth Circuit first noted that Vita Café never took a tip credit. In fact, because Vita Café’s tip pool included non-customarily tipped employees and the plaintiff did not retain all of her tips because of her participation in the pool, it would have been unlawful for Vita Café to take a tip credit under section 203(m). Accordingly, the court concluded that, because Vita Café did not take a tip credit, it was not bound by the constraints of section 203(m) of the FLSA and could fashion its tip-pooling arrangement as it deemed fit, as recognized by the Supreme Court almost 70 years ago.

Arrangement to Distribute Tips to All Employees Is Lawful

Recognizing the weakness of her first argument, the plaintiff claimed that her forced participation in what she characterized as an “invalid tip pool” was the equivalent

of an indirect kick-back to the kitchen staff for the benefit of Vita Café. In doing so, the plaintiff cited to a Department of Labor regulation that requires that an employee’s minimum wage be “paid finally and unconditionally or ‘free and clear.’” The plaintiff argued that because she was required to pool her tips with others, she did not receive the minimum wage “free and clear” or, in other words, that the portion of her tips that went into the tip pool constituted an improper deduction in violation of the FLSA. In rejecting the plaintiff’s argument that the tip-pooling arrangement was an unlawful kick-back to Vita Café, the court referred back to its conclusion that section 203(m) does not change the general rule that tips belong to the servers to whom they are given, *unless there exists an agreement to the contrary*. The court concluded that the tip-pooling arrangement was a lawful “agreement to the contrary,” and did not violate the FLSA because Vita Café did not take a tip credit.

Implications for Employers

This decision is important to many employers within the Ninth Circuit, because they are located in states that prohibit the practice of taking a tip credit against the minimum wage (Alaska, California, Montana, Nevada, Oregon and Washington). It also provides support for employers in other states that wish to implement a system similar to Vita Café’s. One of the advantages of such a system is to redistribute the proceeds of gratuities to all hourly employees, including back-of-the-house employees (positions such as cooks, food preparers and dishwashers). It is common for significant pay disparities to exist between individuals in those positions and those in front-of-the-house positions because the latter share all the proceeds from gratuities generated in the restaurant. Employers considering implementing a new tip-pool arrangement should keep the following in mind:

This ruling does not allow employers to implement a tip-pooling agreement that would allow management to share in the tip pool. Federal and several state laws provide severe if not absolute limitations on the ability of management to receive any portion of gratuities intended for employees.

This ruling does not allow employers to implement a

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tip-pooling agreement that would allow non-servers to share in the tip pool, in states which prohibit or limit the sharing of tips with non-servers.

This ruling does not allow employers to require tip-pooling under state laws or regulations whereby such arrangements must be purely voluntary.

It is sound business practice when implementing a policy requiring redistribution of tips among hourly employees to communicate that policy to employees in writing and to obtain a signed acknowledgment form from all employees.

To avoid any suggestion that the tip-pooling arrangement is actually a tip credit, ensure that employees are paid the higher of the statutorily required minimum wages under federal or state law. In addition, employers must determine whether any state statutes or regulations govern tip-pooling arrangements regardless of the existence of a tip credit. Employers always must ensure that their tip-pooling arrangements comply with federal and state law.

Because of extensive litigation in the area of tip pooling and distribution of proceeds from mandatory service charges, it is also sound business practice for employers who use redistribution arrangements (whether of gratuity or of required service charges, or both) to inform guests about the way in which the proceeds are distributed. This disclosure will provide support in any litigation as to the existence and scope of the redistribution arrangement.

If revising a tip-pool arrangement that involves a tip credit, make sure the arrangement is voluntary, that only non-managerial employees who wait on guests participate in the tip pool and that the arrangement complies with applicable federal and state regulations.

When revising a tip-pool arrangement to create a system of tip redistribution among all hourly employees, make sure that tips are tracked for inclusion as earnings for year-end tax statements and that all individuals that previously did not receive tips are aware that proceeds from tips are a form of earnings that must be reported to the IRS. If an existing tip-reporting agreement is in place with the IRS, make sure all new tip-pool participants sign the required forms and are coded properly for payroll purposes.



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Westminster One-Stop Center	5405 Garden Grove Blvd. Westminster, CA 92863	714-241-4900
Santa Ana W.O.R.K. Center	1000 E. Santa Ana Blvd., Ste. 220 Santa Ana, CA 92701 (At the train station)	714-565-2610
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Employment Tax Audit Area Office	2099 So St College Blvd., Ste. 401 Anaheim, CA 92816-6014	714-935-2920
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