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Pitfalls of Employer-Issued Equipment and Employee Per Diem

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Given the differing roles that PEOs and their client companies play in defining who the “employer” is for tax purposes and liability purposes, deciding who will be responsible for paying for per diems and reimbursing the costs of lost or damaged equipment can be tricky.

Moreover, these issues must be considered from both a state and a federal law standpoint. This *NAPEO Legal Insight™* will focus on the federal issues, but readers must look also to state law in their jurisdictions.

Moreover, the rules vary depending upon the status of employees as exempt or non-exempt.

Usually, the PEO wants the client to be responsible for both per diem and equipment issues. However, the client will look to the PEO for advice about adopting appropriate policies, troubleshooting per diem and lost or damaged equipment, and implementation issues.

Because payment of per diem and wage deductions will most likely become a payroll issue for the PEO, the PEO should take steps to protect itself from unnecessary or unwarranted liability. Per diem items may consist of such things as: allowance for lodging, meals, and incidental expenses. Lost or damaged equipment may include items such as laptop computers, skilled trade equipment, and personal safety gear and equipment.

Problems can arise for a PEO when the client service agreement (CSA) is silent about who has responsibility should any problems arise with respect to per diem and/or the costs of employer issued equipment (see sidebar about the TLC case, page 2). The question is: who is responsible, the client company or the PEO?



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The TLC Case

Transport Labor Contract/Leasing, Inc. & Subsidiaries v. Commissioner of Internal Revenue, 123 T.C. 154 (2004), rev'd on other grounds, 461 F. 3d 1030 (8th Cir. 2006), deals with tax deductions for the cost of employee travel expenses (unless it's treated as income to the employee). In this case, eligible trucking companies were allowed to pay their drivers a fixed per diem for driving expenses. This per diem expense is deductible subject to a 50% limitation for "any expense for food or beverages." The question before the court was: who was responsible for the resulting tax deficiency when neither the PEO nor its clients properly limited the deduction for per diem payments per Section 274(n)?

The record in the *Transport Labor* case shows that the PEO's CSA did not make any reference to per diem payments to truck drivers. It is worth noting that all of this could have been avoided had the client service agreement simply addressed this issue. Fortunately for the PEO, there was a detailed record of the per diem payments made and communication of those payments to the client trucking companies.

The PEO in this case was

Deductions for Lost or Damaged Equipment

Many employers deduct the cost of damaged or lost equipment, such as cell phones, laptops, and equipment, from the wages of employees. Two critical issues must be considered. First, deductions may not reduce the wages of a non-exempt employee below the minimum wage or reduce overtime pay. (See *NAPEO Legal Review*,™ "The Fair Labor Standards Act," www.napeo.org/members/secureDocument.cfm?docID=762). Second, the U.S. Department of Labor (DOL) has issued regulations and opinions letters that such deductions may jeopardize the exempt status of employees under the Fair Labor Standards Act (FLSA). The loss of exempt status can carry potentially serious financial consequences for employers.

Non-Exempt Employees

Disciplinary suspensions without pay are allowed for any reason permitted by a written personnel policy, so long as it is uniformly applied. Deductions for destruction or loss of property or equipment furnished are allowed under certain circumstances. However, deductions in any workweek may not reduce wages below the minimum required by the FLSA (including state minimum wage requirements). When seeking to deduct the cost of the property that is destroyed through the employee's negligence or deliberate action, or if the employee fails to return the item(s) in question, the practice must be a specific subject in the personnel policy and must have been communicated to all. See 29 CFR §§531.35-37.

Exempt Employees

The DOL ruled that making deductions from the salary of exempt employees for damage to or loss of company equipment is impermissible because such deductions violate the FLSA's prohibition against reductions in compensation due to the quality of work performed. As a result, a deduction made to reimburse the employer for lost or damaged equipment could violate the salary basis rule.

Employers may not even require exempt employees to make an out-of-pocket reimbursement for lost or broken equipment, from compensation already received, without running afoul of the FLSA. For instance, in Department of Labor opinion letter FLSA2006-7, then acting administrator Alfred B. Robinson, Jr. opined, "Either approach [deduction or required reimbursement] would result in employees not receiving their predetermined salary when due on a 'guaranteed' basis or 'free and clear' and would produce impermissible reductions in compensation because of the quality of the work performed under the terms of the employer's policies, contrary to 29 C.F.R. § 541.602(a)."

Accordingly, employers may not safely charge an exempt employee for loss of or damage to company property, even if the employee signed an agreement agreeing to the deduction or reimbursement.

Keep in mind that employer liability can vary, depending upon the circumstances, including whether the violation involves an isolated, individual incident or a pattern of conduct. If an employer has made deductions for lost or damaged property for a class of employees, then the exemption may be lost for all employees under the same managerial control whose pay could have been improperly withheld. The ramifications could be sizeable, depending upon how much overtime the affected employees worked, whether the employer has reimbursed the employee for the improper deduction, and other related factors.



Practical Considerations for Lost or Damaged Equipment

- CSA: In your CSA, assign responsibility for deductions for lost or damaged equipment. While you need to tailor such a clause to the requirements of a client and state/federal law, it might read something similar to:

PEO shall have no responsibilities with regard to deducting the cost of lost or damaged equipment from the wages of the worksite employees. Client agrees to provide and assumes responsibility for all facilities, supplies, equipment and all other necessary items that may be required by the worksite employees to perform their employee duties. Client agrees to place the PEO on notice of any wage deductions it takes. Any and all wage deductions must be in accordance with the requirements of the Fair Labor Standards Act, other laws administered by the U.S. Department of Labor's Wage and Hour Division, and any applicable state law.

- Policies/handbook: Advise your client about the rules for exempt and non-exempt employees and make certain any client handbook (or handbook developed by the PEO) addresses the lost or damaged equipment issue and is consistent with the CSA. For example, language might include:

Hourly non-exempt worksite employees may be subject to a salary deduction for lost or damaged equipment. Any and all worksite employees are subject to disciplinary measures for negligence regarding company equipment up to and including dismissal.

Beware the Impact of OSHA on Certain Equipment Provided to Employees

For certain clients, many Occupational Safety and Health Administration (OSHA) standards require employers to provide their employees with personal protective equipment (PPE) necessary to protect them from job-related injuries, illnesses, and fatalities.¹ These can include hard hats, gloves, goggles, shoes, safety glasses, and helmets. The provisions in the OSHA standards that require PPE generally state the employer is to provide the equipment. In 2007, OSHA amended its rules to make clear that the employer was responsible for paying for/providing the required PPE (with the exception of safety-toe shoes/boots and prescription safety eyewear).²

Employee Per Diem

Employee per diem issues pose special challenges for PEOs because of the co-employer situation. The best solution for dealing with per diem is to have specific language written into your CSA specifically defining the role and responsibility of both the client and the PEO.

Practical Implications for Per Diem

- CSA: Have language in the CSA about per diem responsibility, including: defining how the client is handling per diem (as additional wage to worker or business expense to the client); how per diem is reported; how it is to be paid to the worker; and what accounting the PEO will make to the client. Sample language might include:

The client agrees that it will obtain and provide to the PEO at the end of each pay period records of actual time worked by each employee to include per diem

saved by its accurate recordkeeping practices. The PEO had the trucking companies submit a "batch report" every pay period that reflected the gross pay for each truck driver as well as the days on the road for that period. The PEO then paid the drivers based on that information. The pay included the per diem expenses, but those expenses were separated out on the invoices given by the PEO to the trucking company so the breakdown of the aggregate gross pay showed the portion allocated to compensation and to reimbursement of the per diem. The PEO also made sure to collect the necessary information from its client trucking companies to substantiate what they were paying for the per diem payments. In addition, the PEO also sent letters to their client companies showing the total per diem payments made to employees that year and advising the client companies of their responsibility to comply with the deduction limitations in the United States Code.

Thus, despite the fact that the client service agreement was completely silent on the subject of per diem reimbursement, the PEO's ability to accurately show that their client companies established the amount of the per diem

¹ The general rule is at 29 CFR §1910.132.

² 72 *Fed. Register* pp. 64342-01 (November 15, 2007).



payments by collecting mileage and other information from their drivers and submitting it to the PEO was crucial. It was also critical that the PEO provided its client companies with a detailed accounting of the payment breakdown, including the portion allocated for per diem reimbursement. That detail enabled the PEO to demonstrate that it was not subject to the 50% deduction limitation under Section 274(n).

expenses for each worksite employee. Mileage forms and/or receipts for any per diem expenses should be attached to the records. These records shall become the basis from which the PEO shall issue all payroll checks. The amount of per diem will be indicated in each worksite employee's paycheck or may be paid separately.

Summary of Practical Application for PEOs

A PEO should consider the following practical issues. As always, be sure to check with competent counsel to address jurisdictional requirements and make sure provisions regarding a client company's responsibility are in compliance with the laws of that state before implementing any changes to your CSA.

- **CSA:** Include language about the responsibility for per diems, expenses for lost or damaged equipment, company vehicle expenses, etc. in your CSA. Explicitly state whether you or the client company will be responsible for these items and how they will be handled.
- **Policies/handbooks:** Make certain that policies and handbooks are consistent with the CSA and compliant with state and federal law. Employees should be aware of what is permitted, what is not, and what the consequences could be for violations. It's also a good idea to tell employees whom to call if they have questions.
- **Recordkeeping:** Maintain meticulous records of any monies expended on per diems, travel expenses, mileage, etc. Those records should include an accounting of what if any payment the PEO has made.
- **Report:** The client company should submit at least a monthly report detailing these expenses for each employee.
- **Segregate:** Unless a payment is considered to be part of the worker's wages, account for those payments separately.

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