Employers Should Review Internship Programs for Legal Compliance

With summer finally around the corner, employers who utilize interns should review their internship programs to ensure compliance with applicable wage and hour laws. The vast majority of interns in the private sector qualify as employees under the Fair Labor Standards Act (FLSA) and need to be paid accordingly.

The Department of Labor's Six-Factor Test

The U.S. Department of Labor (DOL) uses a six-factor test for determining whether an intern is exempt from the FLSA or, conversely, is an employee subject to the FLSA's protections. While the DOL notes that the intern/employee question "depends upon all of the facts and circumstances" of the program, it also takes the position that all six criteria must be met in order for an intern to fall outside the parameters of the FLSA:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an educational environment;
2. The internship experience is for the benefit of the intern;
3. The intern does not displace regular employees, but works under close supervision of existing staff;
4. The employer that provides the training derives no immediate advantage from the activities of the intern, and on occasion its operations may actually be impeded;
5. The intern is not necessarily entitled to a job at the conclusion of the internship; and
6. The employer and intern understand that the intern is not entitled to wages for the time spent in the internship.

U.S. DOL Wage & Hour Div. Fact Sheet No. 71: Internship Programs Under the Fair Labor Standards Act.

The factors enunciated in the test derive in part from the U.S. Supreme Court's decision in *Walling v. Portland Terminal Co.* (1947). In *Walling*, the Court noted that while the FLSA's definition of "employ" is broad, it "was obviously not intended to stamp all persons as employees who, without any express or implied agreement, might work for their own advantage on the premises of another."

In addition to the DOL's six-factor test, some jurisdictions have other requirements that must be met in order to remove an intern from state wage and hour protections. For example, see New York State DOL, Wage Requirements for Interns in For-Profit Businesses.

Unpaid Internships in the News

The U.S. Court of Appeals for the Second Circuit announced last month that it would hear interlocutory appeals of two unpaid internship cases in tandem. The cases, *Glatt v. Fox Searchlight Pictures, Inc.* and *Wang v. Hearst Corp.*, both involve potential classes of interns who claim they were truly employees and entitled to the minimum wage and overtime protections of the FLSA. Several prominent organizations—such as the Economic Policy Institute, the National Employment Lawyers Association, and the Chamber of Commerce of the United States—have filed amicus briefs in the cases.

In *Fox*, the federal district court held that the interns were employees covered by the FLSA and that they had satisfied the requirements for class certification under both the FLSA and New York Labor Law. Applying the DOL's six-factor test, the district court found that interns on the set of the movie *Black Swan* were performing work that was similar to or displaced that of paid employees. These tasks included drafting letters, making photocopies, organizing filing cabinets, ordering lunches, and running errands.

In *Hearst*, the district court found a material question of fact regarding whether magazine interns who conducted online research, organized files, assisted at photo shoots, ran errands, and performed other tasks were interns or employees. However, the district court refused to certify

the interns as a class, finding that under *Wal-Mart Stores, Inc. v. Dukes*, the plaintiffs had not established the commonality requirement. The court stated that plaintiffs "cannot show anything more than a uniform policy of unpaid internship."

Lawsuits involving unpaid workers are certainly not limited to the east coast. On April 22, 2014, beauty school students filed a complaint against Estee Lauder and Aveda, alleging that the companies violated wage and hour laws by treating students as unpaid employees. That case, *Jennings v. Estee Lauder, Inc.*, is pending in the Superior Court of California, County of Los Angeles.

Outside of wage and hour law, unpaid interns have recently made waves in the civil rights context. Because civil rights laws typically apply only to "employees," interns who fall outside of that definition under the applicable law may not be protected. In *Wang v. Phoenix Satellite Television US, Inc.*, the U.S. District Court for the Southern District of New York found that an unpaid intern could not bring a sexual harassment claim against her former employer under the New York City Human Rights Law because she was not an employee. In response, the New York City Council passed legislation confirming that the law applies to interns, regardless of whether they are paid. N.Y.C. Proposed Int. No. 173-2014A.

Practical Guidance

The DOL takes the position that internships in the for-profit private sector will most often be deemed employment subject to the FLSA. Employers who have unpaid internship programs should review the programs with the DOL's six-factor test in mind, and should consult legal counsel to ensure that any unpaid internship safely falls outside of the employment relationship. The best course of action in the private sector will usually be to treat the interns as employees. Employers who are considering utilizing unpaid interns should:

- Collaborate with educational institutions to determine how the program can build on the academic experience and to assess whether the intern can receive educational credit for participating.
- Assign as the intern's supervisor an individual with knowledge about the substantive area that the intern is to be learning.
- Ensure that supervisors overseeing the intern understand that the intern is not to perform work that other employees would normally perform. Do not utilize interns to displace regular workers.
- Ensure that supervisors and other employees do not assign interns administrative tasks like photocopying and coffee runs that are not related to an educational benefit.
- Offer experiences to the intern that are specifically for the intern's benefit, even if they will impair company operations.
- Require the interns to acknowledge in writing that they understand the program is an internship, that they are not employees, that the program is for their educational benefit, and that they will not be paid.
- Set specific dates for the beginning and end of the internship program so that the program does not morph into employment or something that looks like employment.
- Ensure that the program trains the intern regarding the industry or field generally, and not only regarding work at the specific company.

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Developments in Equal Pay at the Federal and Minnesota State Level

April 8, 2014 has been given the moniker "Equal Pay Day." This date symbolizes how far into the next year women must work on average to earn what men earned in the preceding year. This is based on the broad national statistic that women earn 77 cents on the dollar as compared to men.

In conjunction with "Equal Pay Day," President Obama addressed this topic with executive orders, while the Minnesota legislature debated the "Women's Economic Security Act."

Federal Initiatives

On April 8, President Obama took two executive actions regarding equal pay issues. First, the President issued an executive order barring federal contractors from retaliating against employees who discuss their compensation. The Executive Order has little practical effect, since the majority of employees were already protected in sharing pay information by the National Labor Relations Act.

Second, the President signed a presidential memorandum instructing Department of Labor Secretary Tom Perez to establish new regulations requiring federal contractors to submit summary data on compensation paid to their employees, including data by sex and race. The Department of Labor is expected to use this information to encourage voluntary compliance with equal pay laws and for targeted enforcement.

On April 9, 2014, the Senate failed to pass the Paycheck Fairness Act, which would apply similar requirements to employers who are not federal contractors.

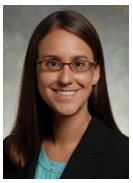
Minnesota Women's Economic Security Act

On April 9, the Minnesota State House passed the "Women's Economic Security Act." The House bill includes the following provisions:

- Amending the Minnesota Parenting Leave Law to provide 12 weeks of unpaid leave for pregnancy and parenting.
- Requiring reasonable accommodations, including seating, restroom breaks, and lifting limits for pregnant employees, and transfer where accommodations are not possible.
- Expanding use of employer-provided paid sick leave to cover care for grandchildren and in circumstances of domestic abuse, sexual assault and stalking.
- Requiring that space provided for nursing mothers must be shielded from view and free from intrusion, and include access to an electrical outlet. Violations of these provisions are subject to the Minnesota Human Rights Act.
- Prohibiting discrimination against family caregivers.
- Adding provisions to Minnesota unemployment law to make it more likely those victims of sexual assault and stalking will qualify for benefits.
- Requiring equal pay certification for state contracts in excess of $500,000.
- Prohibiting employers from taking action against employees who disclose wage information.
- Establishing grant programs to increase the number of women in high wage, high demand non-traditional occupations, and to promote the creation and expansion of women owned businesses.

The Minnesota Senate passed a pared back version of the law on April 23, which includes the parental leave, nursing room and wage disclosure provisions. One provision that does not appear in either House or Senate version is a requirement that employers provide paid sick leave. Proponents had pushed for that provision in the early stages.

This heads next to conference committee and the final law is expected to be signed by May 19.



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New IRS Guidance on Health Flexible Spending Arrangements

Background

Cafeteria plan health flexible spending arrangements, commonly known as "FSAs" or "Health FSAs," are advantageous tax vehicles that allow employees to pay for certain qualifying medical expenses with pre-tax dollars. FSA participants are generally subject to a "use-it-or-lose-it" rule pursuant to which they forfeit all remaining FSA funds on the last day of a plan year if the participant has not incurred the qualifying medical expenses for which the FSA funds can be applied. An exception to this rule is available for FSA arrangements that offer a grace period giving FSA participants an additional period of time (up to two months and 15 days) immediately following the close of a plan year to use unspent FSA funds from the preceding plan year to pay for expenses incurred during the grace period.

As we reported last November, the IRS modified the "use-it-or-lose-it" rule such that an FSA arrangement could, in lieu of allowing a grace period, allow up to $500 unused FSA amounts at year end to be carried over into the immediately following plan year and be used to pay for medical expenses incurred at any time during that next year. FSA participants are prohibited from participating in both a "general purpose" FSA arrangement and a Health Savings Arrangement (HSA) in the same tax year. However, simultaneous participation in an HSA and a "limited-purpose FSA" (also referred to as an "HSA-compatible FSA") is permitted.

New Guidance

In two recently released Chief Counsel Advice memorandums, the IRS issued additional guidance regarding:

- How the new $500 FSA carryover feature operates in connection with the FSA grace period rules and the HSA eligibility rules; and
- Correction methods FSA sponsors may use to correct improper payments made from an FSA.

In Chief Counsel Advice memorandum 201413005, the IRS provides the following guidance:

- Carrying over general purpose FSA funds to the next year precludes participation in an HSA for that entire next year. Accordingly, an individual covered by a general purpose FSA for a part of a year solely because he or she has carried over unused amounts in the FSA from the prior year is not able to make contributions to an HSA for that year. Also, an individual who carries over any amounts to his general purpose FSA may not contribute to an HSA even for months in the plan year after the FSA no longer has any amounts available to pay or reimburse medical expenses.
- Carrying over general purpose FSA funds to an HSA-compatible FSA will not preclude HSA eligibility. Accordingly, there is no requirement that unused amounts in a general purpose FSA must be carried over to a general purpose FSA for the next year. Cafeteria plans that offer both a general purpose FSA and an HSA-compatible FSA may be designed to automatically treat an individual who elects coverage in a high-deductible heath care plan as enrolled in the HSA-compatible FSA and carry over any unused amounts from a general purpose FSA to the HSA-compatible FSA the following year.
- Individuals can elect whether or not to carry over FSA funds before year end. Accordingly, a cafeteria plan may provide that if an individual participates in a general purpose FSA with a carryover feature, the individual may elect before the beginning of the following year to decline or waive the carryover for the following year. If the individual declines, the individual may contribute to an HSA in the next year (assuming he or she otherwise satisfies the HSA eligibility requirements).

In Chief Counsel Advice memorandum 201413006, the IRS provides guidance as to how the sponsor of an FSA must correct "improper payments" made from the FSA. According to the guidance, an FSA sponsor may correct improper payments using the same methods that apply under existing IRS guidance for unsubstantiated payments when an FSA uses a debit card which includes:

- Demanding payment from the participant,
- Withholding amounts from the employee's pay, if allowed under applicable law, and
- Offsetting the amounts owed by the employee against other FSA payments.

Employers are also obligated to recover any overpayments in the same year as the overpayment and may apply any of the above collection methods in any order provided the employer follows that order consistently.

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Minnesota Increases Minimum Wage to One of Highest in the Nation

Minnesota has long had one of the lowest state hourly minimum wage rates in the nation—currently $6.15 per hour for employees of large employers and $5.25 per hour for employees of small employers. The current minimum wage of $6.15 generates a full-time income of $12,792. Minnesota's current state minimum wage rates are below the federal minimum wage rate of $7.25 per hour. On April 14, 2014, Minnesota Governor Mark Dayton signed a law which substantially increases the Minnesota state minimum wage and which now puts Minnesota in the ranks of the states with the highest minimum wages.

The Minnesota state minimum wage will vary based on whether the employer is considered as "large" or "small," and whether the employees are under age 18, trainees under age 20 for the first 90 calendar days of employment, or under certain J-1 non-immigration visas. The threshold for "large" employer was raised so that an increased number of smaller businesses would qualify for lower state minimum wage rates under the law. It is estimated that the changes in the minimum wage will increase earnings for more than 325,000 workers in Minnesota.

Key Features of the New Law

- **Increases beyond federal minimum**: Over time the increases will push Minnesota's minimum wage for all workers beyond the current federal minimum wage $7.25—and where state minimum wage exceeds the federal minimum wage, the higher state wage applies.

- **Effective date for 2014**: The first increase will take effect on August 1, 2014. Later increases will follow in 2015 and 2016.
- **Rates for large employers (employers with at least $500,000 in annual gross revenue):**
    - August 1, 2014 - $8.00 per hour
    - August 1, 2015 - $9.00 per hour
    - August 1, 2016 - $9.50 per hour

    Note that the threshold for a "large" employer is changed under the new legislation—it is currently any enterprise with annual gross volume of sales made or business done of not less than $625,000.
- **Rates for small employers (employers with less than $500,000 in annual gross revenue):**
    - August 1, 2014 - $6.50 per hour (unless subject to higher federal minimum wage of $7.25)
    - August 1, 2015 - $7.25 per hour
    - August 1, 2016 - $7.75 per hour
- **Rates for workers under the age of 18 and for trainees under the age of 20 for the first 90 calendar days of employment:**
    - Same as rate increases for small employers.
    - The youth wage for workers under the age of 18 is new in Minnesota. The training wage for workers under the age of 20 for the first 90 calendar days is being increased substantially from $4.90 per hour to $6.50 per hour in 2014 and ultimately to $7.75 per hour in 2016.
- **Rates for hotel or restaurant workers under an Exchange Visitor non-immigrant visa for summer work who receive a lodging or food benefit:**
    - August 1, 2014: $7.25 per hour
    - August 1, 2015: $7.50 per hour
    - August 1, 2016: $7.75 per hour
- **Wage rate indexed for inflation:** The minimum wage rate will also be indexed for inflation, capped at 2.5 percent per year. This indexing will take effect on January 1, 2018. The state will use the implicit price deflator calculated by the U.S. Department of Commerce's Bureau of Economic Analysis to determine the rate of inflation. However, the Minnesota Commissioner of Labor and Industry has the authority under the law to suspend an indexed increase in the event of a severe economic downturn. In this event, the Commissioner would be required to issue the order no later than September 30 of the year prior to the change, and the state would hold a public hearing and have a public comment period. In the years after a wage increase is prevented, the Commissioner can make supplemental increases in the minimum wage in order to catch up, and such a supplemental increase would not count toward the 2.5 percent cap on inflationary increases. There will be no reductions in the minimum wage in years with negative inflation.
- **No tip credit:** Under Minnesota law, there has been no credit against minimum wages for tips. This remains the case under the new legislation—the legislature rejected proposals that would have created a separate minimum wage for tipped employees.

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