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CLASSIFYING EMPLOYEES FOR WAGES

As a general proposition, employers are required by federal law to pay their employees overtime, usually one and one-half times the hourly pay, for time in excess of 40 hours in a work week. They are also required to pay the minimum wage, which is currently \$7.25 an hour.

The first four groups of employees that are “exempt” from having these rights are executive, administrative, and professional personnel and outside salespersons. For any of the first three exemptions, collectively called the “white collar exemptions,” to apply, the employee must receive, on a salaried basis, at least \$455 per week or its equivalent.

Another commonly invoked exemption is for skilled computer operators who are compensated at a rate of not less than \$27.63 per hour. The following is an overview of these exemptions, but be forewarned that pertinent regulations contain many exceptions and qualifications that must be consulted before an employer can be assured of having complied with applicable federal law.

Exempt Groups of Employees

To be an exempt “executive,” the employee (1) must have, as a primary duty, management of the enterprise or of a customarily recognized department or division of the enterprise; (2) must customarily and regularly direct at least two employees; and (3) must have

hire-and-fire authority as to other employees, or at least be someone whose suggestions and recommendations as to such matters are given particular weight.

An exempt “administrative” employee is one whose primary duty is the performance of office or nonmanual work directly related to the management or general business operations of the employer or its customers, and whose primary duty includes the exercise of discretion and judgment with respect to significant matters. Discretion and judgment are distinguished from skill. For example, clerical workers are typically not exempt as administrative workers. As you might expect, “matters of significance” is a highly elastic concept, but just a few of the many illustrative examples are accounting, quality control, employee benefits, and legal and regulatory compliance.

The “professional” exemption can apply to individuals in any of four groups: learned professionals, who do work in a field requiring advanced knowledge customarily acquired by a prolonged course of specialized intellectual instruction; creative professionals, whose work requires invention, imagination, originality, or talent in a recognized artistic or creative field; teachers, including preschool and trade school teachers, athletic coaches, and advisors for school activities; and doctors and lawyers holding licenses or certifications.

The specialized exemption for “computer employees” comes into play when an employee has primary duties consisting of the application of computer systems analysis techniques and procedures, or the design, development, documentation, analysis, creation, testing, or modification of computer systems or programs.

The exempt “outside salesperson” is generally an employee whose main duty is making sales or obtaining orders or contracts for services or for the use of facilities, and who is customarily and regularly employed away from the employer’s place of business.

Navigating the detailed federal requirements for the exemptions from overtime and minimum wage requirements is a complex business, and the consequences for violating the Fair

Labor Standards Act, from which they emanate, can consume lots of time and money. The stakes for getting this right may be even higher now, in light of an announcement by the Department of Labor that it plans to give increased attention to the problem of misclassification of employees.

The extensive, sometimes highly specific federal requirements for the wage-and-hour exemptions, not to mention their state law counterparts, are best analyzed and applied by employers in consultation with experienced legal advisors or human resource professionals.

UNDERWATER HOMEOWNERS GET A LIFE RAFT

The travails of the housing market in recent years are well documented. The prevalent symbols of this downturn are the “underwater” homeowners, who owe more on their mortgages than their homes are worth. About 4.6 million such homeowners have mortgages backed by Fannie Mae or Freddie Mac, and fully 80% of those owners haven’t missed any mortgage payments.

One way out of the predicament of the underwater owner is the short sale, in which the owner sells the home for less than the balance remaining on the mortgage. It is not a perfect solution that will wipe away all financial problems, but if the mortgage company agrees to a short sale, the underwater owner can “come up for air” by making the sale and paying off at least a portion of the mortgage balance with the proceeds.

In a short sale, holders of first and second mortgages must agree to the deal, because they are accepting less than they are owed. On the whole, short sales are seen as a positive for all concerned—and for the larger economy—but they have been plagued by lengthy delays and lots of red tape.

To address these concerns, the Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac, has recently issued new short sale guidelines. A few different short sale programs will be consolidated into one uniform program, and there will be

clarification of the time by which, when a foreclosure sale is pending, a borrower must submit an application and a sales offer for consideration. The larger goal is to help more homeowners avoid foreclosure, keep more homes occupied, and help maintain stable communities.

These are the highlights of the new guidelines, which took effect on November 1, 2012:

- **A streamlined process for those most in need.** To expedite the process for borrowers who have missed payments, have low credit scores, or have suffered serious financial hardships, the necessary paperwork to demonstrate need will be reduced or eliminated.
- **Easier and quicker qualification for some borrowers with certain hardships who are current on their payments.** Servicers will be allowed to process short sales for these borrowers without any additional approval from Fannie Mae or Freddie Mac. Qualifying hardships include the death of a borrower or primary or secondary wage earner in the household, unemployment, divorce, a long-term disability, an employment transfer or relocation of more than 50 miles one way, increased housing expenses, natural or man-made disasters, or a business failure.
- **Waiver of right to pursue deficiency judgments.** In exchange for a financial contribution, Fannie Mae and Freddie Mac will waive the right to pursue deficiency judgments when a borrower has enough income or assets to make cash contributions or to sign promissory notes. As part of the approval process for short sales, borrowers will be evaluated as to their ability to cover the shortfall between the mortgage balance and the sales price for the property.
- **Relocated military personnel.** Members of the Armed Services who are being relocated will automatically be eligible for short sales, even if they haven't missed a payment. They will also be spared the obligation to contribute funds to cover the shortfall from the short sale.
- **Up to \$6,000 for holders of second mortgages.** In the past, second lienholders

sometimes impeded the short sale process as they negotiated for the highest possible amounts toward what they were owed. As an incentive to make the short sale happen sooner rather than later, Fannie Mae and Freddie Mac will now offer up to \$6,000 to those lenders when the short sale is completed. (But second lienholders will still have the ability to reject short sales if they so desire.)

The new guidelines are just one part of a larger ongoing effort by the FHFA to facilitate various foreclosure alternatives for strapped homeowners. The FHFA recently put into place strict timelines for servicers in the short sale process. They must review and respond to short sales within 30 days of a short sale offer, provide weekly status updates to the borrower for offers still under review after 30 days, and make and communicate final decisions within 60 days of receiving an offer and the complete borrower response package.

HOW LONG HAS THIS BEEN GOING ON?

Even if you're a taxpayer with simple returns and few supporting documents, you can become a little snowed under by tax records as they accumulate over the years, raising the question of how long you should hold on to such records. The answer depends on the types of documents and transactions involved, but if you have been a tax records pack rat for many years, chances are you can safely dispose of the oldest such records without inviting trouble.

As a starting point, you must keep tax records that support the income, deductions, and credits on your tax return, and you should also keep copies of the returns themselves. As for how long to retain the records, a good rule of thumb is to keep them until the limitations period runs out for the return in question.

The "limitations period" refers to the amount of time you have to amend a return to claim a credit or a refund or in which the IRS can assess additional taxes. As a general rule, the

limitations period for a return is three years after it has been filed, but if you file early, the period runs from the date the return was due to be filed.

For most general rules there are exceptions, and that is the case with keeping tax records. If you failed to report income in an amount that is more than 25% of the gross income shown on your return, keep the records for six years, not three. If you filed an amended return to get a credit or refund, keep the records for either three years from the date you filed the original return or two years from the date you paid the tax, whichever is later.

After filing a claim for a loss from worthless securities or a bad-debt deduction, hang on to any relevant records for seven years. Employers should retain all employment tax records for at least four years after the tax was due or has been paid, whichever is later.

If you did not even file a return or filed a fraudulent return (it has been known to happen), all of the above rules are out the window, because the limitations period never expires. Keep those records indefinitely. Also, even if you did not amend a return, some types of records should be kept for extended periods. Among the records in this category are those relating to securities and real estate, nondeductible contributions to retirement accounts, and home improvement expenditures.

For the space-conscious among us, the good news is that retaining even voluminous amounts of tax records these days may not have to take up any more room than the space occupied by your computer. The IRS allows taxpayers to store tax documents electronically, whether they originated electronically or on paper.

PITFALLS OF BEING AN EXECUTOR

As a general rule, the executor of an estate does not have personal liability for the debts and obligations of a decedent. Lest executors become complacent, however, they should be

aware of an important exception to that rule, which was illustrated by a recent federal court case between executors and the Internal Revenue Service (IRS).

At the time of her death, the decedent had a substantial unpaid income tax liability, in the range of a half-million dollars. There was no question that the two executors of her estate, one of whom was her son, had been aware of that liability, since they had received letters from the IRS advising them of a federal tax lien on real property owned by the decedent and of their obligation to satisfy that debt.

The executors had even unsuccessfully challenged the lien in an administrative appeal. Despite this knowledge, they conveyed the real property to the executor-son for one dollar. The son then sold the property for an amount in excess of the tax liability, but later claimed that the proceeds “pretty much got blown away in the market.”

The IRS prevailed in its federal court lawsuit against the executors, seeking satisfaction of the tax liability from them. The winning theory was that the executors, by disposing of the real estate without having first satisfied the income tax liabilities of the decedent, had violated their duties as fiduciaries of the estate of the taxpayer.

The IRS proceeded under a federal statute that holds a fiduciary liable, to the extent of unpaid claims of the government, if the fiduciary disposed of assets of an estate before paying the government. Three elements must be present for such a cause of action, and they were all shown by the IRS in the case before the court: (1) the fiduciary distributed assets of the estate; (2) the distribution rendered the estate insolvent; and (3) the distribution took place after the fiduciary had actual or constructive knowledge of the liability for unpaid taxes.

The applicable concept of joint and several liability of the executors had the potential for an especially bad outcome for the executor who had conveyed the real property to his coexecutor, the son of the decedent. If the son does not have enough money or assets to pay the tax debt—a probable outcome given his travails in the market—the other executor could be on

the hook for the entire debt, even though he never had the benefit of the proceeds from the sale of the property. Executors be forewarned: Be sure that Uncle Sam gets what is coming to him before distributing estate assets to beneficiaries.

401(K) LOANS AND HARDSHIP WITHDRAWALS

You won't find many financial advisors who vigorously advocate dipping into the money in your 401(k) retirement account while you're still working. It is for retirement, after all. Still, using some of what could be a sizeable amount of money sitting in the account for current financial needs may sometimes be too great a temptation to resist. Taking that step is not always ill-advised, but you should know all the ramifications before doing so.

Borrowing

The first way to access funds in a 401(k) before retirement is by borrowing from the account. Generally you can borrow up to 50% of the vested amount in the account, up to a maximum of \$50,000. As compared with shopping around for a loan, this approach has the relative advantages of involving minimal paperwork, bypassing credit scores, and paying the interest payments on the loan back to your own retirement account.

A downside for borrowing from a 401(k) account is that to the extent that you deplete the balance in the account, you will have less money with which to take advantage of tax-deferred accumulation in the account. As the borrower, you must also be wary of adverse tax consequences.

First, the loan will be repaid by reductions in your future paychecks, and, unlike the usual contributions to a 401(k) account, those repayments will be made with after-tax dollars; this means that such repayment amounts will be taxed twice, once when the money is initially paid to you and again when you take the money out when you retire.

Second, while you would generally have five years to repay the loan, if you leave the company earlier you may have to repay the loan in as few as 60 days. Failure to meet that deadline would result in owing income tax on the unpaid loan amount and, if you are under age 55, also paying a 10% penalty, to boot.

Hardship Withdrawal

Another alternative for getting early access to a 401(k) account is a hardship withdrawal, but the name means what it says. The IRS says that there must be an immediate and heavy financial need, usually meaning expenses for items such as medical care, education, or housing or funeral expenses.

A hardship withdrawal is not subject to the dollar-limit for loans, but generally you can't even qualify for a hardship withdrawal unless you can't meet your financial obligations from other resources. In the same vein, if you are eligible, you may have to borrow as much as possible from the 401(k) account first, before getting a hardship withdrawal.

However, if using up your other resources and taking out a 401(k) loan will increase your need, the employer can't withhold a hardship withdrawal for your failure to have taken those steps first. Hardship withdrawals are subject to ordinary income tax and, depending on the timing, an additional 10% early withdrawal penalty.

Our lives are full of surprises, some of them financial. Sometimes unforeseen circumstances will arise that make a 401(k) loan or hardship withdrawal a reasonable step toward meeting pressing immediate needs and therefore achieving more financial stability. Still, the conventional wisdom on this topic holds true: These steps should be taken only when all other approaches have been exhausted or found to be unavailable for some reason.