

LABOR & EMPLOYMENT and TAX & BUSINESS PLANNING

A L E R T

JUNE
2010GETTING READY FOR SUMMER — EMPLOYMENT AND
TAX LAW GUIDELINES FOR HIRING INTERNS

Facing tighter budgets and historically high unemployment levels, employers have been steadily offering an increasing number of internship opportunities with their businesses. With the summer months fast approaching, a time when students across the country are willing to obtain “real world experience” for little to no money at all, hiring interns might seem like the perfect opportunity to get some extra help around the office. However, as the number of internships increases, so has the federal government’s concern that employers are using internship programs to take advantage of students and others in violation of federal employment and tax laws. To avoid the risk of violating the law, employers who hire interns must get it right.

Proper Classification of Interns for Wage & Hour Purposes — Interns or Employees?

Signaling plans for closer scrutiny of unpaid internships, the United States Department of Labor’s Wage and Hour Division (DOL) recently published Fact Sheet #71, *Internship Programs Under the Fair Labor Standards Act*, which is designed to help employers determine whether interns must be paid minimum wage and overtime under the Fair Labor Standards Act 29 U.S.C. 201, *et seq.* (FLSA) for the services that they provide to for-profit, private-sector employers.¹

Generally, the FLSA requires that employees receive at least minimum wage for all hours worked and time-and-a-half pay for all hours worked over 40 in a workweek. Under the FLSA, individuals who are “suffered or permitted” to work are considered to be “employed” and must be compensated for the services they perform. In Fact Sheet #71 the DOL explains that internships in the for-profit sector “will most often be viewed as employment” that must be compensated unless the employer can demonstrate that an intern is working in an internship or training program for his or her own educational benefit. The DOL has developed a six-part test to determine whether an internship or training program qualifies for this exclusion. While the DOL declares that its determination of whether the exclusion applies depends on the facts, it makes clear that, in all

cases, all of the following six factors must be satisfied:

#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. The fact sheet notes that an internship is more likely to be viewed as part of an educational experience if it is “structured around a classroom or academic experience.” An example is where a college or university supervises the internship program and provides the intern with educational credit.

#2: The internship experience is for the benefit of the intern. The DOL emphasizes in the fact sheet that an internship should provide an intern with skills that he or she can use in multiple employment settings, as opposed to skills particular to the employer’s business. It further cautions that if interns engage in an employer’s operations, *e.g.*, by performing clerical work or assisting customers, they will not be excluded from the FLSA’s minimum wage and overtime requirements because the employer is benefitting from the interns’ work.

#3: The intern does not displace regular employees, but works under close supervision of existing staff. The fact sheet makes clear that the DOL will consider an internship to resemble an employment relationship where the employer would have hired additional employees or required current employees to work additional hours but for the presence of interns. Employers should be providing “shadowing opportunities” to interns where the interns perform minimal work under close supervision. If the interns receive the same level of supervision as the employer’s regular workforce, it would suggest an employment relationship rather than training for the educational benefit of the interns.

#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. The fact sheet explains that a true intern should not perform the routine work of a business on a regular and recurring basis, and the business should not depend upon the intern’s work.

1. Unpaid internships in the public sector and with nonprofit organizations are generally permissible where the intern volunteers freely and without expectation of compensation. It is expected that the United States Department of Labor’s Wage and Hour Division will be issuing additional guidance on internships in the public and non-profit sectors.

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#5: The intern is not necessarily entitled to a job at the conclusion of the internship. The fact sheet states that an internship should be for a fixed duration with no expectations by either party beyond the internship. The employer should not use an internship as a trial period to evaluate an intern for possible future employment.

#6: The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

Those who participate in unpaid internships that do not meet all six of the above criteria could subject a business to liability for unpaid wages and fines imposed by the DOL. To ensure compliance with the DOL's rules, businesses offering unpaid internships should structure their programs to make certain that the intern, and not the business, receives the full benefit of the experience. One way of securing this goal is to create written agreements with interns that outline the terms of the unpaid internship. These include the goals, tasks and expectations for both the intern and the business during the internship, and a clear statement that it is an educational experience. Unpaid internship agreements and program activities should be periodically reviewed to ensure continued compliance with DOL rules.

Proper Classification of Interns for Tax Purposes — Independent Contractors or Employees?

Employment of interns also requires attention to tax matters. For withholding and payroll tax purposes, workers are typically classified as either "employees" or "independent contractors." Interns are generally properly classified as employees, although the facts and circumstances in some situations may give rise to independent contractor status. Worker classification must be carefully considered, especially as enforcement efforts have been stepped up recently. In 2010, the IRS is conducting audits as part of an agency-wide effort to track compliance with employment tax regulations among all filers of employment tax reports. Members of Congress are also concerned about misclassification of workers. Pending legislation, if adopted, would require employers to file additional information with the IRS when claiming independent contractor status for a worker.

Failure to properly classify a worker as an employee and to withhold, report and pay over income and payroll taxes could result in significant tax and legal implications. For example, an employer may be held liable for failure to withhold income and Federal Insurance Contribution Act (FICA) taxes, and also assessed interest and penalties, if a worker classified by the employer as an independent contractor is reclassified by the IRS as an employee. Misclassified workers may also be

entitled to retroactive participation in qualified pension plans (e.g., 401(k) plans, pension plans, and profit-sharing plans) and welfare benefit plans (e.g., cafeteria plans, group health insurance plans, and group life insurance plans), which can be costly for an employer.

How Can Legal Counsel Help?

Legal counsel can help employers carefully structure internship programs with these factors in mind by reviewing the advertisements and applications for such positions and the internship agreements themselves. Legal counsel can also offer guidance and "best practices" on structuring relationships with individuals who are intended to be independent contractors. ♦

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This document is a basic summary of legal issues. It should not be relied upon as an authoritative statement of the law. You should obtain detailed legal advice before taking legal action.

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