Client Alert | Employment, Compensation & Benefits

Federal Employment Law Updates

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New Tax Law Limits Deductibility of Confidential Sexual Harassment and Abuse Settlements

Effective December 22, 2017, new Section 162(q) of the Internal Revenue Code of 1986, as amended (the "Code"), denies businesses the right to make deductions for amounts paid in settlements of, and for attorney's fees incurred in defense of, sexual harassment and sexual abuse allegations, if such settlements or payments are subject to nondisclosure agreements.

Section 162 of the Code generally allows businesses to deduct certain ordinary and necessary expenses paid or incurred during the year. Prior to the addition of new Section 162(q) of the Code, amounts paid in confidential settlements and for attorney's fees incurred in defense of sexual harassment and sexual abuse allegations that resulted in such confidential settlements could be taken as a business deduction—thereby reducing the economic impact of the settlement on the Company.

Under new Section 162(q) of the Code, an employer can no longer claim a business deduction for "(1) any settlement or payment related to sexual harassment or sexual abuse *if such settlement or payment is subject to a nondisclosure agreement*, or (2) attorney's fees related to such a settlement." (Emphasis added) The new Section applies to settlements and attorney's fees paid after December 22, 2017, even if a settlement was reached before that date. It also applies to settlements involving recurring payments, where a portion of the payments will be made after December 22, 2017.

NLRB Reinstates More Narrow "Joint Employer" Test

The federal National Labor Relations Board ("NLRB" or the "Board") recently revised its standard for assessing joint employer status under the federal National Labor Relations Act ("NLRA") by adopting the more narrow test traditionally used by the Board before 2015. We note President Trump has appointed two (2) individuals, Marvin Kaplan and William Emanuel, to serve as Board members since taking office on January 20, 2017.

As reported in our October 2015 Client Alert, the Board had previously broadened the joint employer standard applied under the NLRA in *Browning-Ferris Industries of California Inc.*, 362 NLRB No. 186 (Aug. 27, 2015). In that case, the Board stated that "[t]he right to control, in the common law sense, is probative of joint-employer status, as is the actual exercise of control, whether direct or indirect." Notably, the Board did not require a showing of actual use of direct and immediate control over terms and conditions of employment to determine an entity's status as a joint employer. Instead, the Board held that a showing of reserved authority was sufficient to determine that an entity was a joint employer.

The Board has now reversed course and returned to the traditional common law standard for determining when an entity is a joint employer. The traditional test provides that two or more entities will be deemed joint employers under the NLRA if there is proof that one entity has *exercised* control over essential employment terms of another entity's employees (rather than merely having reserved the right to exercise control) and has done so *directly and*

immediately (rather than indirectly) in a manner that is not limited and routine. In *Hy-Brand Industrial Contractors, Ltd.*, 365 NLRB No. 156 (Dec. 14, 2017), the Board overruled the expanded standard previously adopted in *Browning-Ferris*. In so doing, the Board stated that the *Browning-Ferris* ruling had exceeded the NLRB's statutory authority and had distorted the interpretation of common law agency principles. Going forward, the Board held that there must be evidence of actual control in order to determine that an entity is a joint employer.

U.S. DOL Permits More Flexible Test For Having Unpaid Interns

On January 5, 2018, the United States Department of Labor (the "DOL") issued a Fact Sheet[1] (the "DOL Fact Sheet") setting forth new guidelines for determining whether interns and students working for "for profit" employers are required to receive minimum wage and overtime pay under the federal Fair Labor Standards Act (the "FLSA"). The new guidelines apply the "primary beneficiary" test to determine whether interns and students must be paid as employees rather than the more restrictive six (6)-factor test previously used by the DOL.

Six-Factor Test

Under the former test used by the DOL since 2010, interns and students would need to be treated and paid as regular employees unless all six of the following criteria were met: (i) 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; (ii) the internship experience is for the benefit of the intern; (iii) the intern does not displace regular employees, but works under close supervision of existing staff; (iv) 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; (v) the intern is not necessarily entitled to a job at the conclusion of the internship; and (vi) the employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

"Primary Beneficiary" Test

A number of federal appellate courts (the Second, Sixth, Ninth and Eleventh Circuits) had found the six (6)-factor test to lack the flexibility to apply to all workplaces, especially the requirement that the employer may not derive any immediate advantage from the intern's activities. These courts instead applied a more forgiving standard for employers, focusing on the "primary beneficiary" of the parties' relationship and assessing the "economic reality" that exists in different employer-intern contexts.

For example, the Ninth Circuit recently used the primary beneficiary test to determine that cosmetology students who were provided "hands-on training" needed for the state licensing exam were not employees of the salon in which they worked, even if the salon received some immediate advantage from the students' work. The Court noted that the students (i) enrolled in the program with the knowledge that they would not be remunerated for their work, (ii) received hands on training for academic credit, (iii) did not displace the work of paid employees, as staff was maintained to instruct the students, (iv) received clinical work that corresponded to their academic commitments, and (v) did not have an expectation of employment upon graduation. Similarly, the Second Circuit also recently held that interns could be unpaid even though the interns displaced some of the employees' work because "it is no longer a problem that an intern was useful or productive."

The "primary beneficiary" test consists of the following seven factors, none of which are dispositive, and should be applied to the unique circumstances of each case to determine the nature of the relationship and which party is the primary beneficiary:

1. The extent to which the intern and the employer clearly understand that there is no expectation of compensation. Any promise of compensation, express or implied, suggests that the intern is an employee—and vice versa.

2. The extent to which the internship provides training that would be similar to that which would be given in an educational environment, including the clinical and other hands-on training provided by educational institutions.

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[1] https://www.dol.gov/whd/regs/compliance/whdfs71.pdf

3. The extent to which the internship is tied to the intern's formal education program by integrated coursework or the receipt of academic credit.
4. The extent to which the internship accommodates the intern's academic commitments by corresponding to the academic calendar.
5. The extent to which the internship's duration is limited to the period in which the internship provides the intern with beneficial learning.
6. The extent to which the intern's work complements, rather than displaces, the work of paid employees while providing significant educational benefits to the intern.
7. The extent to which the intern and the employer understand that the internship is conducted without entitlement to a paid job at the conclusion of the internship.

If the court determines, based on the totality of the circumstances, the factors weigh toward the individual as the primary beneficiary, he or she is deemed an intern, and not entitled to minimum wage or overtime pay under the FLSA. If the test confirms the employer as the primary beneficiary, the individual is an employee and is entitled to minimum wage and possibly overtime pay under the FLSA.

Notwithstanding the change in the DOL's position, courts (at least outside of the four Circuits noted above) could still apply a more restrictive test when determining whether interns and students should be treated as employees under the FLSA. In addition, state law might require application of a more restrictive test when making such determinations under state wage and hour law.

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