Ohio Bar®
Connect. Advance. Succeed.

Labor and Employment News

WINTER 2024
Published by the Ohio State Bar Association
Labor and Employment Law Section

Exempt Employee Compensation Thresholds: An Update

By Alicia Nesline Shaw

On April 26, 2024, the Department of Labor (DOL) published its long-awaited final rule updating the salary thresholds for certain exemptions from minimum wage and overtime compensation under the Fair Labor Standards Act (FLSA).[1] The new rule sought to significantly increase the salary threshold for certain FLSA exemptions. Accordingly, employers with "exempt" employees have been following the progression of the final rule and the court battles that have ensued to evaluate the impact on their workforce and plan for implementation, which has already partially occurred.

A Quick Recap of "Exempt" Status Under the FLSA

At its most basic, the FLSA mandates that employees receive at least minimum wage for all hours worked[2] and overtime compensation (1.5 times their regular rate of pay)[3] for any time worked over 40 hours in a workweek (a designated period of seven consecutive days).[4] In order to qualify as "exempt" from one or both of these pay requirements (minimum wage and/or overtime compensation), an employee must generally satisfy certain compensation thresholds and job duties tests. These thresholds and tests vary depending on the classification in which the employee qualifies as "exempt."

In its rules, the DOL changed the compensation requirements for employees under the following exemption classifications:

INSIDE

1. Executive
2. Administrative
3. Professional
4. Highly Compensated Employee (HCE)

In the case of each of these four exemptions, the properly exempt employee is paid a regular salary of at least a minimum threshold and satisfies the applicable job duties test for the exemption. The exemptions above are typically classified as the "white collar" exemptions, but each of the executive, administrative and professional (EAP) exemptions have their own job duties tests.[5] Currently, the minimum salary threshold for either of the EAP exemptions is $684 per week ($35,568 annualized). For the HCE, it is $107,432 on an annual basis (which includes at least $684 per week paid on a salary or fee basis).

Changes to the Thresholds

As of July 1, 2024, the minimum salary thresholds increased to:

- $844 per week ($42,888 annualized) for EAP exemptions.[6]
- $132,964 annual salary for the HCE exemption.[7]

As of Jan. 1, 2025, the minimum salary thresholds were set to increase to:

- $1,128 per week ($58,656 annualized) for EAP exemptions.[8]
- $151,164 annual salary for the HCE exemption.[9]

The new rule also provides for adjustments to these thresholds every three years, beginning on July 1, 2027.[10]

On Nov. 15, 2024, the United States District Court for the Eastern District of Texas[11] overturned the final rule nationwide, holding that it constituted an unlawful exercise of agency power that went beyond the scope of the authority granted to the DOL by Congress. As a result, the minimum salary threshold returns to the pre-July 2024 amount of $35,568 per year for the exempt employees discussed above. The DOL has the option to appeal the decision.

Takeaways for Employers

While the 2024 final rule likely will not go into effect, every employer should still take this opportunity to fully evaluate whether or not employees are properly classified as exempt based on job duties ***and*** salary threshold. If an employee satisfies the job duties requirements of their exemption, but does not meet the minimum salary threshold, changes are necessary. However, if an employer finds that an employee fails to satisfy the job duties requirements of the purported exemption, this is the opportune time to make a correction and transition that employee to nonexempt status.

About the Author

Alicia Nesline Shaw is an attorney at the firm of Carlile, Patchen & Murphy where she focuses her practice on business services, business transactions, employment law, family wealth, estate planning and probate law. She is a former chair of the Columbus Bar Association's Labor & Employment Law Committee. Shaw earned her undergraduate degree from the University of Richmond and her law degree from The Ohio State University Moritz College of Law.

Endnotes

[1]Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales, and Computer Employees, 89 Fed. Reg. 32,842 – 32,973 (April 26, 2024) (revising 29 C.F.R. § 541).
[2] 29 U.S.C. §206.
[3] 29 U.S.C. §207.
[4] 29 C.F.R. §778.105.
[5] See 29 C.F.R. Part 541 Subpart B, Subpart C and Subpart D.
[6] 29 C.F.R. §541.600(a)(1).
[7] 29 C.F.R. §541.601(a)(1).
[8] 29 C.F.R. §541.600(a)(2).
[9] 29 C.F.R. §541.601(a)(2).
[10] 29 C.F.R. §541.600(a)(3) and 29 C.F.R. §541.601(a)(3).
[11] *State of Texas v. U.S. Department of Labor*, No. 4:24-cv-499 (E.D. Tex. Nov. 15, 2024).

The FTC's Ban on Noncompete Clauses Is Dead … For Now

By Jordan C. Butler

In a monumental move impacting employment practices across the nation, the Federal Trade Commission (FTC) announced on April 23, 2024 a final rule banning most noncompete clauses nationwide. This rule, which was supposed to come into effect on Sept. 4, 2024, carried profound implications for employers and employees. However, courts have since overturned the rule. Though the rule is not in effect, the FTC has appealed certain court decisions and the rule could be resuscitated. Employers and employees alike should therefore still be generally aware of the rule and its prohibitions and requirements.

Understanding Noncompete Clauses

A noncompete clause is a contractual provision that prohibits employees from engaging in certain competitive activities during their current employment and after leaving their current employment.[1] These activities typically include seeking employment with a competitor or starting a competing business.[2] The FTC rule targets these restrictive covenants, aiming to safeguard workers' mobility and promote fair competition in the labor market.

Key Provisions of the Rule

The rule outlines specific provisions regarding noncompete clauses:

1. Prohibition for most workers. For all workers except senior executives, employers are barred from entering into, enforcing or representing the existence of noncompete clauses.[3]

2. Definition of senior executive. The rule defines a "senior executive" as a high-level employee with policy-making authority who was paid at least $151,164 in the preceding year or will be paid $151,164 when annualized in the current year. A "policy-making position" refers to individuals, such as a manager, director or officer with authority to make policy decisions for the employer.[4]

Only noncompete clauses entered into before the rule's effective date will remain valid for senior executives.[5]

3. Effective date and enforcement. The rule was slated to take effect on Sept. 4, 2024. Had the rule gone into effect, noncompete provisions applicable to most workers would have become unenforceable nationwide.

Exceptions and Nuances

While the rule imposes broad restrictions on noncompete clauses, several exceptions and nuances apply:

- **Business sale and ownership interests**. Noncompete clauses entered into as part of bona fide business sales or transfers of ownership interests are permissible.[6]

- **Preexisting causes of action**. Actions relating to noncompete violations occurring before the rule's effective date remain unaffected.[7]

- **Confidentiality and nonsolicitation provisions.** While not stated in the rule, the FTC has clarified that confidentiality and nonsolicitation provisions are generally permissible, provided they do not function as *de facto* noncompete clauses.

Employer Obligations
Under the rule, employers must notify employees subject to existing noncompete provisions that these provisions will become unenforceable.[8] This notice may be delivered by hand, mail, e-mail or text message, but cannot be communicated verbally.[9] The rule contains sample language that may be used for such notices.[10]

Legal Challenges
As expected, the FTC's rule faces several legal challenges:

- On July 3, 2024, the U.S. District Court for the Northern District of Texas, in the first case filed challenging the rule (*Ryan LLC v. FTC*) granted the plaintiff a temporary injunction, enjoining the FTC from enforcing the rule. However, the injunction prohibited the FTC from enforcing the rule against plaintiff Ryan LLC (and certain plaintiff intervenors). This ruling did not affect the enforceability of the rule against most employers nationwide. The *Ryan LLC* court held that the FTC lacked the authority to enact the rule and that the rule was arbitrary and capricious.[11]

- On July 23, 2024, a federal court in Pennsylvania sided with the FTC, denying the plaintiff a preliminary injunction to enjoin the FTC rule from taking effect.[12]

- On Aug. 14, 2024, a federal court in Florida granted a preliminary injunction to stay the effective date of the rule applicable as to the plaintiff only. However, unlike the *Ryan LLC* court, the Florida court ruled that the FTC does *generally* have the statutory authority to issue substantive rules regulating unfair methods of competition, but nevertheless issued the preliminary injunction on the grounds that the rule violates the "major questions doctrine," i.e., the FTC did not show clear congressional authorization to issue the rule.[13]

- Finally, Aug. 20, 2024, the U.S. District Court for the Northern District of Texas granted summary judgment to the plaintiff in *Ryan LLC*, permanently enjoining the FTC from implementing and enforcing the rule.[14] This time, however, the ruling did not apply only as to the plaintiff. Rather, the decision prohibits the FTC from enforcing the rule against all employers nationwide.

On Oct. 18, 2024, the FTC filed an appeal with the U.S. Court of Appeals for the 5th Circuit, seeking to overturn the *Ryan LLC* decision.[15] In Sept. 2024, the FTC also appealed to the United States Court of Appeals for the 11th Circuit the August 2024 Florida ruling, which applied only to a single employer.[16] As of mid-November 2024, these appeals remain pending.

Future Outlook
It is not expected that the 5th Circuit or 11th Circuit will render decisions until sometime in 2025. If the courts issue differing opinions, then the matter may ultimately be resolved by the U.S. Supreme Court.

It is also worth noting that, with the 2024 presidential election results, leadership at the FTC *could* change in 2025, resulting in potentially different opinions and philosophies about the rule within the FTC and possibly even a decision by the FTC to abandon the appeals.

Conclusion
The FTC's ban on most noncompete provisions represented a significant step toward enhancing worker mobility and fostering a more competitive labor market. Though the rule is currently on the shelf, employers and employees alike should familiarize themselves with the rule's provisions in case the FTC prevails in its appeals.

About the Author

Jordan Butler is a partner with Carlile Patchen & Murphy where he helps individuals and business owners with tax advice and planning, business transactions, mergers and acquisitions, real estate transactions, trademark registrations, and other commercial and business matters. He serves as chair of the firm's Tax Law Practice Group and Business Law Practice Group. Jordan earned his undergraduate degree from Miami University, his law degree from Capital University Law School and an LL.M in taxation from the University of Miami School of Law.

Endnotes

[1] 16 C.F.R. §910.1
[2] *Id.*
[3] 16 C.F.R. §910.2(a)(1)
[4] 16 C.F.R. §910.1.
[5] 16 C.F.R. §910.2(a)(2)
[6] 16 C.F.R. §910.3(a)
[7] 16 C.F.R. §910.3(b)
[8] 16 C.F.R. §910.2(b)(1)
[9] 16 C.F.R. §910.2(b)(2)
[10] 16 C.F.R. §910.2(b)(4)
[11] *Ryan LLC v. FTC*, No. 3:24-cv-00986 (N.D. Tex. Apr. 23, 2024)
[12] *ATS Tree Services, LLC v. FTC*, No. 2:24-cv-01743 (E.D. Pa. Apr. 25, 2024)
[13] *Properties of the Villages, Inc. v. FTC*, No. 5:24CV00316 (M.D. Fla. June 21, 2024)
[14] *Ryan LLC v. FTC*, No. 3:24-cv-00986 (N.D. Tex. Apr. 23, 2024)
[15] *Id.*
[16] *Properties of the Villages, Inc. v. FTC*, No. 5:24CV00316 (M.D. Fla. June 21, 2024)

Labor and Employment Legislative Update

By Scott Lundregan and Marisa Myers
Ohio Bar Government Relations Team

While the 135th General Assembly has yielded a historically low number of enactments, labor and employment law practitioners still have much to keep their eyes on when it comes to recent developments in the practice area. Here are a few items of note to the Labor and Employment Law Section.

Minimum Wage Ballot Issue
An initiative petition was circulated and signatures were collected to amend Ohio's Constitution to increase the minimum wage to $15 per hour on Jan. 1, 2026. The minimum wage would increase to $12.75 on Jan. 1, 2025 and then increase to $15.00 on Jan. 1, 2026. Perhaps most notably, the proposed amendment also requires that tipped employees be paid the same minimum wage as non-tipped employees. This led to harsh opposition from the Ohio Restaurant and Hospitality Alliance.

Ultimately, the group circulating the petition did not get enough signatures to make it on the November 2024 ballot but did announce that it would continue to collect signatures to put the ballot issue before the voters in 2025. However, there are questions about whether this will hold up in court because the ballot initiative increases the minimum wage on Jan. 1, 2025 and voters would then be voting on a retroactive amendment.

There are also multiple bills pending in the legislature that would raise the minimum wage (noted below). It is likely we will see them reintroduced next year.

Noncompete Ban
The Federal Trade Commission's (FTC) proposed a ban on noncompete clauses in employment contracts that was to take effect on Sept. 4, 2024. There were several exceptions to this proposed rule, including senior executives, noncompete agreements that resulted from the sale of a business, and certain entities including banks and credit unions. However, this proposed rule was blocked by a federal court in Texas in August 2024. Learn more about the details via the article on pg. 3.

Legislation

Adult Use Marijuana
One of the biggest areas of disagreement between the House and the Senate is over recreational marijuana in Ohio. In 2023, voters overwhelmingly passed Issue 2, an initiated statute that provides for adult recreational use of marijuana. Since it is an initiated statute, the legislature is free to make changes to it as it sees fit.

Some of the areas where the legislature and the governor have expressed an interest in making changes include the tax rate, how the tax revenue is spent, modifying home-grow provisions, lowering permissible THC levels and outlawing delta 8/9 THC, which derives from hemp and is unregulated. However, there is no consensus on making changes in the House, with several members expressing opposition to altering voter-approved language. While there was a chance for a legislative package to be enticing to strong supporters of Issue 2 (since it could have sped up the timeline for rollout of the program) the moment has passed, as the program is now live.

There has not been much legislative discussion about the labor and employment side of Issue 2 because most believe that the initiated statute gives employers clear authority to prohibit the use of marijuana and terminate someone for violating their policy. However, the Senate did include some relevant modifications in its package of marijuana related reforms.

Issue 2 considers a person to have been discharged from employment for just cause under the Unemployment Compensation Law if the person violates the employer's formal program or policy regulating the use of marijuana. Additionally, the Senate, via HB86, sponsored by Rep. Jeff LaRe (R-Violet Township), added a clarification to that provision to state that such a person who has been discharged for violating the employer's marijuana policy is ineligible to serve a waiting period or be paid unemployment benefits for the duration of the person's unemployment. The Senate also made it clear in HB86 that it is not a violation of Ohio's Civil Rights Law if an employer discriminates against an employee for using marijuana in violation of the employer's workplace policy.

Labor Law Notices on Internet
HB273, sponsored by Rep. Adam Mathews (R-Lebanon), and SB96, sponsored by Sens. George Lang (R-West Chester) and Steve Wilson (R-Maineville), would both allow for required labor notices to be posted on the internet in a manner that is accessible to the employer's employees. As of this writing, SB96 has passed the Senate and passed out of House committee, with a House floor vote expected any day.

Youth Working Hours
SB30, sponsored by Sen. Tim Schaffer (R-Lancaster), would allow a 14- or 15-year-old to be employed after 7 p.m. during the school year. Current law allows 14- and 15-year-olds to be employed from 7-9 p.m. between June 1 and Sept. 1. This bill would allow that schedule all year, with the approval of a parent or legal guardian. SB30 has passed the Senate and has passed out of House committee, meaning it too is pending a House floor vote and is one step away from being sent to the Governor.

Below is a list of other legislation that is relevant to the labor and employment practice, with statuses current as of this writing. All remain in early stages of the legislative process, but we expect to see some reintroductions of these bills next year:

- HB96, sponsored by Reps. Dontavius L. Jarrells (D-Columbus) and Ismail Mohamed (D-Columbus) would increase the state minimum wage.

- HB334, sponsored by Rep. Michele Grim (D-Toledo) and former Rep. Jessica Miranda (D-Forest Park), would enact the Strike Term Access to Negotiation Duration Unemployment Protection Act (STAND UP Act) regarding unemployment benefits during labor disputes.

- HB398, sponsored by Rep. Munira Abdullahi (D-Columbus) and former Rep. Jessica Miranda (D-Forest Park), would prohibit employers from seeking a prospective employee's wage or salary history.

All three of the above bills are pending in the House Commerce and Labor Committee.

- HB422, sponsored by Rep. Lauren McNally (D-Youngstown), would apply the employment portions of the Ohio Civil Rights Law to unpaid interns. It has been referred to the House Civil Justice Committee where it has received one hearing.

- SB47, sponsored by Sen. Stephen Huffman (R-Tipp City), would prohibit a public employer from providing paid leave or compensation for a public employee to engage in certain union activities. It is pending in the Senate Judiciary Committee, where it has had one hearing.

- SB180, sponsored by Sen. Paula Hicks-Hudson (D-Toledo), would provide unemployment benefits to striking workers. It has had one hearing in the Senate Insurance Committee.

- SB256, sponsored by Sen. Louis Blessing III (R-Colerain Township), would modify the state's earned income tax credit and increase the basic state minimum hourly wage. It has received two hearings in the Senate Ways and Means Committee.

- SB303, sponsored by Sens. George Lang (R-West Chester) and Hearcel Craig (D-Columbus), regulate the provision of earned wage access services. It has been introduced in the Senate but has not received a committee assignment.

Ohio Bar Priorities
Though, as we mentioned above, it's been a slow year, legislatively speaking, the last session before the summer recess did yield several enacted bills, including most of the Ohio Bar's priorities.

Learn about those bills and other Ohio Bar priorities via this Ohio Lawyer magazine Statehouse Connection article.

And keep up with developments in pending legislation each week via the Ohio Bar Weekly Legislative Report. Delivered every Friday via your OSBA Report "Greenbook" and always available on your Member Dashboard.

In Case You Missed It

By Priscilla Hapner

In case you missed it, these are a few brief summaries of court decisions from the past several months involving employment law.

U.S. Supreme Court

Employment Discrimination. The Court reversed the summary judgment dismissal of a sex discrimination lawsuit on the grounds that the plaintiff is *not* required to prove that an involuntary lateral transfer *significantly* affected the terms and conditions of her employment. *Muldrow v. City of St. Louis, MO*, 601 U.S. 346 (2024). In particular, the plaintiff alleged that, even though her pay and title remained the same after the transfer, she was denied the use of an unmarked vehicle to use after her shift, was required to sometimes work weekends and no longer worked with higher ranking officers. "Although an employee must show some harm from a forced transfer to prevail in a Title VII suit, she need not show that the injury satisfies a significance test." Nonetheless, the Court observed that the significance of the changed working conditions may be considered in assessing whether the employer intentionally discriminated. "[A] court may consider whether a less harmful act is, in a given context, less suggestive of intentional discrimination."

Arbitration. The Court held that a court may not dismiss (even without prejudice) a case which is subject to mandatory arbitration under the Federal Arbitration Act. *Smith v. Spizzirri*, 601 U.S. 472 (2024). Rather, the FAA provides that such proceedings shall be "stayed" – or held in abeyance – pending arbitration. Therefore, when a party (in this case an employer) moves to compel arbitration of the underlying employment claims and stay the proceedings, it was an error for the court to compel arbitration and then dismiss the case without prejudice. The court's inherent authority to dismiss a case is subject to the FAA's statutory requirement to stay the proceedings.

Arbitration. The Court held that a worker need not work in the transportation industry to qualify for the Federal Arbitration Act exemption for the "class of workers engaged in foreign or interstate commerce." *Bissonette v. LePage Bakeries Start St. LLC*, 601 U.S. 246 (2024). The statutory language providing the exemption focuses on the worker and not the industry. "A transportation worker need not work in the transportation industry to fall within the exemption from the FAA provided by §1 of the Act."

6th Circuit

Reverse Discrimination. The court affirmed an employer's summary judgment on a female employee's Title VII claim that she was discriminated against for being a heterosexual. *Ames v. Ohio Department of Youth Services*, 87 F.3d 822 (6th Cir. 2023) 2024 U.S. Lexis 3065 (Oct. 4, 2024). The district court had found that she had failed to prove sufficient "background circumstances" to support a reverse discrimination failure-to-promote claim or pretext to rebut the employer's explanation regarding her demotion for merely satisfactory job performance. The Supreme Court has granted *certiorari* to determine whether "background circumstances" are required in a reverse discrimination claim when there is no statutory basis for such a requirement.

Noncompetes. The court affirmed a divided decision concerning the enforcement of a noncompete, trade secret and nonsolicitation agreement which the employee was required to sign as a condition of being hired. *Total Quality Logistics LLC v. EDA Logistics, LLC*, No. 23-3713, 2024 U.S. App. LEXIS 25149 (6th Cir. 10-2-24). First, it refused to prevent the employee from working in the logistics industry because it agreed that the employer had failed to produce specific evidence of the "special" training it had allegedly provided to support such a broad restriction even though the employee had no prior logistics experience. Second, while it agreed that the employee could not solicit the employer's customers, it refused to impose any damages because the employer failed to show what efforts it made to keep those customers after the employee's resignation or what specific profit it lost. Merely relying on the revenue generated for the employee's new business was insufficient to justify requested monetary damages. Third, it refused to find that the employee misappropriated trade secrets based on contacting specific customer contacts from his personal knowledge gained in his prior employment or already in his cell phone. "[I]nformation retained in the [employee's] cell phone could not support a trade-secret claim." There was no evidence that he had taken or used any confidential master customer list or could not have re-created his new customer list from cold calling, etc. Finally, the court refused to enforce the one-sided prevailing party attorney fees provision because it found the provision to be unenforceable in a contract of adhesion.

Workplace Harassment. The court affirmed a jury verdict finding that the employer had not discriminated or retaliated against the plaintiff, but had subjected her to a hostile work environment on account of her gender. *Schlosser v. VRHabilis, LLS*, 113 F.4th 674 (6th Cir. 2024). The court rejected the employer's attempt to restrict to the harassment claim to verbal abuse and concluded that the discrete acts of discrimination – upon which the jury had refused to impose liability – could also be considered to support the harassment verdict.

Workplace Harassment. The court affirmed the summary judgment dismissal of an age discrimination claim but reversed dismissal of the companion hostile work environment claim brought by a former police officer. *McNeal v. City of Blue Ash*, No. 23-3180, 2024 U.S. App. LEXIS 24123 (6th Cir. 9/23/2024). The court agreed that the plaintiff officer could not show that his termination – or the underlying disciplinary actions – were discriminatory or pretextual. However, he could possibly show a hostile work environment based on the cumulative effect of closer scrutiny and supervision than his younger coworkers received, a denigrating assignment that could be designed for him to fail and his supervisor's "glee" in imposing disciplinary actions against him. The court's opinion suggests that hostile work environments need not be severe or subjectively hostile when discriminatory employment actions need not be significant in order to be actionable: "Because hostile-work- environment claims arise out of the same statutory language as disparate-treatment claims, *Muldrow's* holding that Title VII does not require plaintiffs to show "significant" harm applies to both types of claims . . . Thus, when we consider whether a hostile work environment was severe or pervasive enough to violate Title VII, we effectively ask whether it left an employee 'worse off respecting employment terms or conditions.'"

Similarly Situated. The court affirmed an employer's summary judgment on an age discrimination claim brought by a disappointed employee who was denied a promotion after repeatedly failing the aptitude test passed by younger employees. *Walden v. General Electric Int'l, Inc.* 119 F.4th 1049 (6th Cir. 2024). The plaintiff could not show that he was qualified for the promotion when he continued to fail the test. The court rejected his arguments that he was qualified because he satisfied the requirements of the job posting, which did not mention the established testing requirement. The court also found that the younger, successful employees were not similarly-situated because they passed the test and he did not. The court also rejected his speculative arguments that the younger employees did not complete the test by themselves.

Release of Claims. The court reversed an employer's summary judgment on racial discrimination and retaliation claims. *Moore v. Coca-Cola Bottling Co.*, 113 F.4th 608 (6th Cir. 2024). The majority agreed that the plaintiff produced enough evidence to demonstrate a factual dispute about whether he was treated differently than white coworkers when he was terminated for testing six times higher than the prohibited threshold while two white coworkers were treated more leniently under comparable circumstances. The court refused to enforce the release of claims he signed in a last chance agreement given for insubordination despite his college education and failure to request more time to consider it when the entire meeting lasted about 10 minutes, the *union* vice-president encouraged him to sign it and the release of "all" claims against the employer arising out of employment did not specifically mention discrimination claims. The court remanded for the trial court's consideration whether placing him on a second chance agreement and requiring random drug testing after he tested positive for marijuana below the employer's prohibited threshold was discriminatory. The court also found that the employer waived its affirmative defense to his failure to exhaust administrative remedies by failing to raise with the district court the plaintiff's failure to file a charge of discrimination about the second chance agreement or mention it in a later charge about his suspension and last chance agreement.

ADA. The court affirmed an employer's summary judgment on disability discrimination and failure to accommodate claims based on the former employee's withdrawal/failure to participate in the interactive process. *Wilson v. ODMAS*, No. 23-3994, 2024 U.S. App. LEXIS 20770 (6TH Cir. Aug. 14, 2024). The court agreed that the employee failed to show that she proposed a reasonable accommodation when she refused to complete or return forms from her physician confirming the disability and necessity for the requested accommodations of schedule flexibility and telework even though she had previously requested and exhausted FMLA leave and short-term disability. This was a "critical failure" to participate in, and "voluntary withdrawal" from, the interactive process necessary to prevail on a failure to accommodate claim.

Further, the court rejected her argument that the employer's failure to accommodate was a "continuing violation," and dismissed the remaining allegations since her accommodation requests had been made more than two years before she filed suit and were, therefore, untimely.

Lactation Discrimination. The court affirmed a school employer's summary judgment on a retaliation and harassment claim brought by a nonrenewed special education teacher who had alleged that she was terminated in retaliation for taking lactation breaks. *Childers v. Casey County School District Board of Education*, No. 23-5317 , 2024 U.S. App. LEXIS 19389 (6th Cir. Aug. 1, 2024). Although she brought the claims under Title IX and Kentucky state law, the court applied Title VII burdens of proof to find that the employer's explanation – her failure to timely submit forms to fund a student's education – was not pretextual in light of the sporadic and stale allegations in her complaint.

Fair Credit Reporting Act. The court found that Experian violated the FCRA when it failed to investigate or clarify a consumer report about outstanding child support obligations after the consumer provided it with evidence from the court that he owed no outstanding child support obligations. *Berry v. Experian Information Solutions, Inc.*, 115 F.4th 528 (6th Cir. 2024).

Fair Credit Reporting Act. The court found that the job applicant could not sue an employer for failing to provide him with a copy of his complete consumer report after it provided him with a copy of a partial (and accurate) report when he could not identify how he would have acted differently or been able to cure his prior failure to self-disclose a conviction. *Merck v. Walmart, Inc.*, 114 F.4th 762 (6th Cir. 2024).

Fair Credit Reporting Act. The court affirmed an employer's summary judgment on a defamation and tortious interference claim brought by a former employee who claimed that he had been defamed and prevented from obtaining new employment based on a negative job reference that the defendant employer provided to a consumer reporting agency. *McKenna v. Dillon Transp.* LLC, 97 F.4th 471 (6th Cir. 2024). The court agreed that the plaintiff's state law claims were preempted by the Fair Credit Reporting Act. The court rejected the plaintiff's argument that a similar federal statute governing employment/safety references of commercial drivers provided liability for his claims because it did not specifically preempt the FCRA and was compatible with it.

First Amendment. The court reversed a public library employer's summary judgment and granted the employee summary judgment on the §1983 First Amendment claim of a security guard who was terminated in 2020 after he briefly posted on his private FB account a highly offensive and hyperbolic meme criticizing the BLM protests. *Noble v. Cincinnati & Hamilton County Public Library* 112 F.4th 373 (6th Cir. 2024). In finding that his First Amendment rights outweighed the employer's efficiency interests in maintaining a harmonious workplace, "there is no proof that any patron objected to [his] meme or even saw it. But, in any event, it was not a prerequisite to be a security guard at the Library that the guard share the politics of book borrowers or librarians."

NLRB/Failure To Bargain. The court affirmed enforcement of the NLRB's order against an employer which had failed to negotiate with the union about the effects of a layoff and presented severance agreements to the laid off employees without first informing or negotiating with the union about the terms of those agreements. *NLRB v. McLaren Macomb*, No. 23-1335/1403, 2024 U.S. App. LEXIS 23969 (6th Cir. Sept. 19, 2024). Because

that conduct – by itself – was sufficient to violate sections 8(a)(1) and (5) of the NLRA, the court declined to consider the employer's objections to the NLRB's alternative conclusion that the terms of the severance agreement – concerning confidentiality and non-disparagement – constituted independent 8(a)(1) violations. Accordingly, the employees were ordered reinstated with backpay.

COVID. The court reversed an employer's summary judgment on a Title VII religious discrimination claim alleging that the plaintiff had been fired for not conforming to the employer's religious beliefs which were hostile to, among other things, his social distancing during the pandemic. *Amos v. LAMPO Group, LLC*, No. 24-5011, 2024 U.S. App. LEXIS 19821 (6th Cir. Aug 6, 2024).

COVID. The court affirmed the continuation of a state law lawsuit where the plaintiff had been fired for refusing the COVID vaccine and rejected the employer's argument that it was immune as a federal contractor because the government's vaccine mandate was unlawful. *Riggs v. UCOR, LLC*, No. 23-6116, 2024 U.S. App. LEXIS 19405 (6th Cir. Aug. 2, 2024).

COVID. The court reversed an in-home medical care employer's judgment dismissing a job applicant's Title VII complaint that she was rejected for employment on account of her religious belief to refuse the COVID vaccination. *Lucky v. Landmark Med. of Mich., P.C.*, 103 F.4th 1241 (6th Cir. 2024). The court found that she had sufficiently pled "her refusal to receive the vaccine was an 'aspect' of her religious observance or belief." "It is not within the judicial ken to question the centrality of particular beliefs or practices to a faith, or the validity of particular litigants' interpretations of those creeds." Courts are not at the pleading stage to evaluate "the plausibility of a religious claim." Her complaint's "allegations would support an inference of religious conduct for a person of any faith."

COVID. The court affirmed the dismissal of all but two claims filed by employees who claimed that the hospital employer's initial blanket denial of their religious objections to the COVID-19 vaccine constituted religious discrimination in violation of Title VII and the Ohio Civil Rights Act. *Saval v. MetroHealth System*, 96 F.4th 932 (6th Cir. 2024). The employer had reversed its decision and ultimately granted all of the religious exemption requests. Thus, the employees who remained employed never suffered any concrete injury to justify litigation from "conclusory" allegations of the emotional distress caused over 36 days while they were forced choose between their jobs and their religious convictions or from the employer's ability to reverse course again in the future. Several of the employees had resigned before the employer denied the exemption requests, and thus, also lacked any injury from the employer's initial denial decision. However, two employees could sue for disparate treatment and failure to accommodate when they resigned more than 18 days after their requests were denied even though the employer had granted some medical exemption requests.

Withdrawal Liability. The court reversed a wife's liability and affirmed a husband's liability for over $1M in withdrawal liability from a multi-employer union pension plan of a single member corporation formerly owned and managed by the husband several years earlier. *Local 499 v. Art Iron, Inc.*, 117 F.4th 923 (6th Cir. 2024). While the evidence showed that the husband was the sole owner of the defunct corporation and his consulting business, there was no evidence that the wife's hobby business of making jewelry was regular and continuous as required.

Ohio Supreme Court

COVID. The Court held that civil service employees were permitted to appeal whether their COVID furlough was a layoff governed by seniority rules. *Harmon v. Cincinnati*, No. 2024-Ohio-2889. "Common pleas court [was] not divested of jurisdiction to hear city employees' administrative appeal regarding whether separation from employment under temporary emergency-leave program implemented in response to COVID-19 pandemic constituted a layoff." The Court found that the bargaining agreement permitted civil service appeals and the civil service commission's failure to conduct an evidentiary hearing when it should have done so did not destroy jurisdiction or render it a non-quasi-judicial matter.

Teaching contracts. The Court strictly construed the teacher observation statute to find that the defendant school board did not comply with the statute before voting to not renew the plaintiff teacher's employment. *Jones v. Kent City School Dist. Bd. of Edn.*, No. 2024-Ohio-2844. "When considering nonrenewal of a teacher's limited teaching contract under R.C. 3319.11(E), school board must conduct three observations of the teacher being actually engaged in teaching to comply with the teacher-evaluation procedures set forth in R.C. 3319.111(E) . . ." The trial court was found to have abused its discretion in affirming the district's decision when the third evaluation (during the teacher's medical leave) constituted only interviews with students instead of observation of actual teaching.

Ohio Courts

Noncompetes. The Franklin County Court of Appeals affirmed a preliminary injunction and summary judgment against a former department head for breaching his noncompete agreement when he formed his own competing business and later performed work for his former employer's customers. *Capital City Mechanical, Inc. v. Bartoe*, 2024-Ohio-4550. While the court agreed that the employee could perform work for the employer's customers if he was hired by an unrelated company which also provided services to the same customer, he was barred from performing services for his employer's customers for two years even without a geographic limitation. He also could not prevail on a tortious interference claim when the employer was permitted to inform entities that he had a noncompete agreement and when he could not show a firm expectation of being hired for any work.

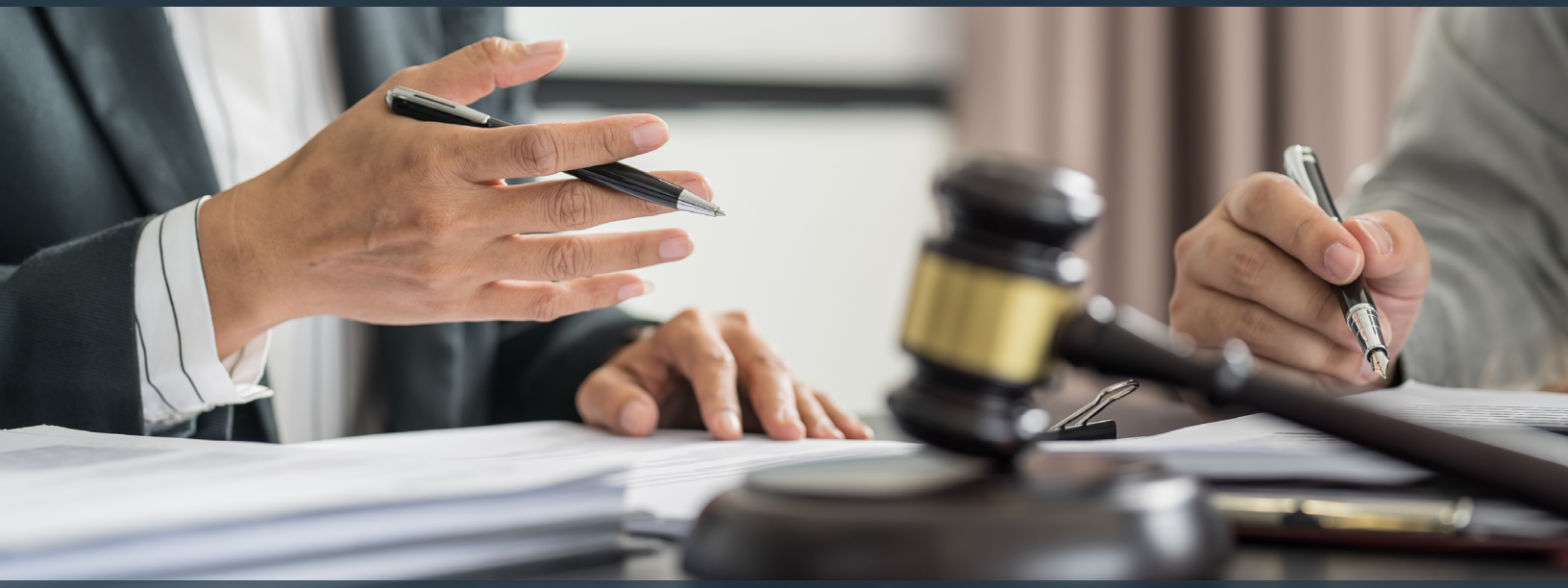
Coworker Harassment. The Lorain County Court of Appeals affirmed a jury verdict of over $150K in compensatory and punitive damages for coworker sexual harassment, constructive discharge and negligent supervision claims as well as almost $69K in attorney fees. *Morgan v. Consun Food Industries, Inc.*, 2024-Ohio-2300. The plaintiff proved that she was treated differently when her complaints were ignored and when she was disciplined for misconduct while male employee misconduct on the same evening was ignored. "[H]arassing conduct that is simply abusive, with no sexual element, can support a claim for hostile-environment sexual harassment if it is directed at the plaintiff because of his or her sex." Further, management's indifference to her complaint and failure to address incidents with the harassing employee destroyed its affirmative defense.

Wrongful Discharge. The Highland County Court of Appeals affirmed the Rule 12(B)(6) dismissal of a complaint filed against a bank for pregnancy discrimination and wrongful discharge in violation of public policy. *Storer v. Natl. Coop. Bank*, 2024-Ohio-1676. The court concluded that there is no public policy in Ohio prohibiting an employer from discharging an employee who shared internal, private emails with her boyfriend's attorney concerning a legal dispute with her employer. While public policy may protect consulting with an attorney about the employee's own legal problems, that policy does not extend to protect the employee from consulting with a third party's attorney about his problems. Further, the complaint failed to allege sufficient facts to show that her termination was related in any way to her pregnancy. Simply making "speculative" and "conclusory" allegations that she was fired while pregnant cannot survive a motion to dismiss.

Arbitration. The court affirmed the denial of a motion to compel arbitration and held that the trial court was not required to hold a jury trial on the enforceability of the clause. *Costin v. Midwest Vision Partners* LLC, 2024-Ohio-463. The parties had amended the plaintiff's employment agreement upon his termination of employment and specified which clauses of his former agreement would survive termination of his employment. The arbitration clause was not one of the provisions that the amended agreement listed as surviving his employment termination. Accordingly, the trial court could grant summary judgment on that issue.

Arbitration. The court reversed and remanded the dispute where the plaintiff's age discrimination claim had been stayed pending arbitration because the trial court had failed to consider the plaintiff's argument that the "loser pays" provision of the arbitration clause was unconscionable, contrary to public policy and unenforceable. *Grimm v. Professional Dental Alliance, LLC*, 2024-Ohio-637.

About the Author
When she is not reading and summarizing court decisions, Priscilla Hapner advises awesome employers and exceptional employees in Central Ohio



I Am Not a Tax Lawyer and I Don't Play One on TV

What employment lawyers need to know about tax issues in settlement and severance agreements

By Christina M. Royer, Lesley A. Weigand and Faith C. Whittaker

As employment lawyers, when we settle a case or assist a client with a severance arrangement, we cannot draft settlement or severance agreements "in a vacuum." Because these arrangements invariably involve the payment of money from an employer to an employee, when we draft language in these agreements, we must be mindful of the tax implications of the provisions we're including. As much as we would like to be creative – and we can be, for sure! – we don't want to inadvertently walk our clients into problems with the IRS or an unanticipated tax burden.

The easiest way to illustrate the common tax issues that can come up in employment cases is to filter hypothetical settlement and severance scenarios through the lens of a tax lawyer so that we can be sure that we are dotting all the I's (for IRS) and crossing all the T's (for taxes) in putting together these agreements.

Scenario 1: Settling an ADA and FMLA case that was filed in court.

Mary was terminated from her employment with Company A, a private employer, after taking Family Medical Leave Act (FMLA) leave to treat for cancer and whose disabling condition was not accommodated within a week after her return. After filing a charge of discrimination with the Equal Employment Opportunity Commission (EEOC), Mary filed suit in federal court, alleging claims under the Americans With Disabilities Act (ADA) for failure to accommodate and disability discrimination – claims for failure to accommodate and disability discrimination under Chapter 4112 of the Ohio Revised Code and claims for interference and retaliation under the FMLA. Mary's complaint asked for the following types of damages: lost wages (back pay and front pay), emotional-distress damages, punitive damages, liquidated damages under the FMLA, as well as attorney fees and costs.

Mary settles her case for $100,000 total. The payment(s) to her will be paid lump sum, with a separate payment of $40,000 to her legal counsel for attorney fees.

How should Mary's $60,000 be allocated in the settlement agreement? How should the payment(s) to her and/or her counsel be reported to the IRS?

Remember, ask yourself this question: "In lieu of *what* were these damages paid?"

1. While many clients and attorneys would like the answer to be "emotional distress" and/or "personal physical injuries" or something along that line, to prevent the award from being subject to employment taxes or, in the case of physical injuries, to make the award non-taxable under IRC §104(a), this is just not realistic in the context of an employment claim, especially where the complaint states that Mary did return to work and was let go because the employer could not accommodate her. Therefore, we need to look at what *is* most realistic.

2. The most typical type of recoverable damages in employment cases is wage-based, such as back pay and front pay. Back pay and front pay are subject to withholding (federal, state and local), then also subject to employment taxes (FICA, FUTA, Medicare), in addition to employer match. A W-2 should be issued to the employee to report any wage-related settlement or damage awards.

3. What about any claimed emotional distress and what if the client actually does suffer some kind of physical harm relating to the emotional distress? The primary question is whether there are medical bills to support a claim.

   A. If yes, is there a medical insurance subrogation issue that we need to be concerned about? (That might be worse than being taxed, given the administrative headache of subrogation!)

   B. What evidence came out in the case about the physical manifestations of Mary's emotional distress? For example, maybe Mary suffered from migraines, stomach issues or some other physical manifestation of emotional harm?

   C. At the end of the day, both the employee and the employer need to be ready to justify any dollar amount attributable to physical manifestations of emotional distress, and there definitely needs to be supporting documentation or testimony. If there is only a claim of bad headaches, sleepless nights, or gastrointestinal disturbance (while all of those are definitely bad and quite painful), it is best to be sensible and not strike the conscience of the IRS. Remember, the goal is to stay *under the radar of the IRS.*

   D. Generally speaking, it is best to allocate a settlement, or portion of a settlement, to personal, physical injury *only* where the facts of the case warrant it, such as an egregious case where there is a physical assault that resulted in injuries.

   E. In most employment cases, emotional distress is "garden variety," so it is taxable to the client, although not subject to employment taxes. This type of payment is not subject to any withholdings and is reported on Form 1099-MISC, in box 3.

4. Punitive damages and liquidated damages are always taxable.

   A. Here, because Mary is settling her claim, it is not going to be tried before a trier of fact, so there would not be an award of punitive damages, per se. Therefore, no defense attorney is going to agree to any amount for punitive damages or liquidated damages because any wrongdoing is specifically denied and the case is being settled.

   B. In this context, there is really no point to allocating any part of a settlement to punitive damages or liquidated damages. Any damages claimed beyond lost wages can be characterized as emotional distress or non-wage compensatory damages, which are taxable (see above).

   C. However, changing the facts slightly, what happens if the case went to a jury and there were a jury verdict in favor of the plaintiff and punitive and liquidated damages were awarded? Consider then a settlement upon appeal. In that instance, a portion of the settlement could be allocated to punitive damages and liquidated damages as long as the underlying amount for lost wages was paid in full. In that instance, the punitive and liquidated damages would be reported on Form 1099-MISC, in box 3.

Scenario 2: Now, consider a severance situation – with variations.

Mary worked for Company A, a private employer that merged with Company B. As a result of the merger and to eliminate duplicate positions, Mary was laid off as part of a reduction in force that impacted several Company A employees. As part of the layoff, Company A offered a severance arrangement whereby Mary, who was earning $250,000 per year, will receive 26 weeks of severance and continued healthcare under COBRA for the 26-week severance period. Mary does not have any viable discrimination, or other, claims against Company A.

Mary's $125,000 in severance will be paid out over time, as payroll, starting in November 2024 and ending in May 2025. Mary will elect COBRA and the company will pay the insurance premiums directly to the COBRA administrator.

Variations on the theme: 1) Mary will receive a lump-sum payment in November 2024. She will elect COBRA and the lump-sum payment is meant to cover both the $125,000 in severance, along with the COBRA premiums and/or 2) Mary will pay the COBRA premiums herself and Company A will reimburse her directly for them.

What are the tax implications of Mary's severance arrangement?

A. If her severance is paid out over time with healthcare premiums paid directly to the healthcare provider, straddling two tax years:

1. The cost of the healthcare premiums is not taxable to Mary because those costs are paid directly by the employer for her health care.

2. The wages are reported on W-2 over a period of two years that the severance is received.

B. If her severance is paid out in a lump sum that covers both severance pay and COBRA premiums:

Unfortunately, a bad result here. See *Adkins v. United States of America*, 693 F. Supp. 574 (N.D. Ohio 1988) (Dowd, J.). Judge Dowd, in his opinion, explained that when a lump sum is received, the employees can do anything they want with the funds, they do not have to be used for health care premiums. Contrast that with the below scenario. The entire lump sum – which includes both severance pay and health care premiums – would therefore be subject to withholding and employment taxes and reported on a W-2.

Practice Pointer: While it may be rare to see a provision like this in a severance agreement, if there is one, an attorney representing the employee should absolutely ask that the employer restructure these payments to ease the tax burden on the client. Otherwise, the client will be subject to withholding and employment taxes on the portion of the severance that is supposed to pay for healthcare. This is not ideal!

C. If Mary pays the COBRA premiums herself and the company reimburses her for them:

The reimbursement for the healthcare premiums is not taxable to Mary and therefore not reported. The reason these payments are not taxable is because they are readily identifiable and easily calculated. *See Adkins*, citing Rev. Rul. 61-146, 1961-2 C.B. 25.

If the employer were to pay Mary a lump sum up front, which she could then use to pay for health care premiums, that amount would be subject to withholdings and reported on Form W-2.

What about attorney fees paid to the employee's counsel?

The reporting and taxation of attorney fees depends on whether they are paid as part of a contingent-fee arrangement and whether they are paid hourly, and whether the employee's claims are considered "employment discrimination claims" under the Internal Revenue Code (IRC). Let's start with contingent fees earned, most typically in a settlement scenario:

1. Attorney fees are **required** to be reported to the employee. The employee should receive a 1099-MISC with the fees reported in box 10 (2024 form).

2. As long as the nature of the claim falls into the statutory definition of an "unlawful discrimination claim," the employee is permitted an above-the-line deduction for these fees on Form 1040, Schedule 1, line 24(h), so the net effect is that the employee is not taxed on the attorney fees paid to his or her attorney.

3. IRC §62(e) sets forth a laundry list of what the IRS defines as "unlawful discrimination." Note that this definition is different from how employment lawyers may view what is considered unlawful discrimination.

4. Of particular note though is IRC §62(e)(18), which is the catch-all provision and allows an above-the-line deduction for the following:

> Any provision of Federal, State or local law, or common law claims permitted under Federal, State or local law (i) providing for the enforcement of civil rights, or (ii) **regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law.**

This catch-all provision covers the waterfront. In the tax code itself, any claim about employment is actually defined as an unlawful discrimination claim, thus allowing the above-the-line deduction.

💡 ***Practice Pointer***: While most claims that we deal with will fall into this definition, there are a few that may not. For example, if you are bringing a defamation claim against a former employer or a tortious interference claim, attorney fees for those may not be deductible. In such a situation, it is good to get outside tax advice as to how the attorney fees are treated for tax purposes.

---

5. Technically speaking, the employee then should issue a 1099-MISC to his or her attorney. In reality, that will never happen so in practice, the employer issues a check for the attorney fees directly, per the settlement agreement. The attorney should receive a 1099-MISC from the employer as well, with the fees reported in box 10.

6. Clients should take their settlement agreement and the attorney's fee invoice to their tax preparer so that their tax preparer can properly deduct the attorney fees on the proper line of the 1040.

7. Clients should also tell their CPA that they received an ***employment*** settlement and explain that the attorney fees are deductible. It has greatly helped that there is now a line item on Form 1040, Schedule 1, line 24(h) to deduct the attorney fees above the line so even those tax preparers who may not be familiar with this scenario should be able to figure it out.

8. Also, the employee's counsel should ask their clients who their tax preparer is and tell them this is not the year to go to H&R Block. (Nothing against H&R Block, but an employment settlement is an anomaly and not something these mass producers of returns see every day).

So what happens if the employee's counsel charges her client hourly, which can happen in settlement negotiations and is quite common in severance situations?

1. If the fees are paid in the same tax year that the settlement is reached, it is the exact same scenario as in contingent-fee arrangements, except that the employer would not issue a 1099 to the employee (because the employer did not pay the fees to the attorney, the employee did).

2. However, if the attorney bills monthly and the representation spans over two tax years, then the fees that have been paid for the prior period cannot be deducted on line 24(h) of Schedule 1. Here is the nuance with how deductions work: Deductions are taken in the year in which they are paid. However, there is no resolution (i.e. payment) in those prior periods to take those fees against.

💡 ***Practice Pointer***: If possible, try to accrue the fees and wait to bill them until the matter has been resolved. Therefore, there is no timing issue between when the fees were paid and when the settlement proceeds were received. This should not be too difficult in practice because generally, negotiations are wrapped up in a matter of a few months.

---

*A small catch-22 arises when a settlement is negotiated at the end of the year. If the client will receive the payment by Dec. 31, then the attorney fees must be paid by Dec. 31 to be deductible.

**Another option is to ask the client to pay the attorney fees with their credit card by Dec. 31 (and utilize the float) or just pay the fees from other assets but pay it by Dec. 31. If there are client funds in IOLTA to pay the client's bills, ask the client for permission to bill them, and move the funds to the firm's operating account by Dec. 31.

3. In this scenario, clients should take the severance agreement, the attorney-fee invoice and proof of payment to their CPA and explain that these fees are deductible on Form 1040, Schedule 1, line 24(h). If there are questions, the CPA can call the attorney.

Is there any way to control, or limit, the increased federal withholding that may result from a large, lump-sum payment?

Going back to Mary's settlement hypothetical, she will receive a lump-sum payment of wages that likely far exceeds the pay she would usually receive in a given pay period. As a result, the federal withholding rate on this lump sum will be very high. This is because most payroll systems assume that the employee earns the lump-sum amount each pay period and adjusts the tax rate accordingly.

In some cases, the employee may be able to submit a new W-4 to the employer and adjust her exemptions; the higher the exemptions, the less tax is taken out. Employers cannot adjust withholding without a new W-4. However, as employment lawyers, it is best not to get into the client's personal tax situation.

If the client needs advice on how to fill out Form W-4, the best advice is to tell them to consult with their CPA. There are many variables that go into withholding, not least of which are other sources of income the employee has and/or what has already been paid in via estimated payments throughout the year.

💡 ***Practice Pointer***: It can sometimes help to advise clients to be fiscally responsible and suggest mechanisms that will help them to help themselves in financial situations, such as a settlement or severance. Therefore, what is the worst thing that could happen if there was too much withholding? They get a bigger refund next year! Not a bad thing. However, what happens if not enough money was withheld, and they owe taxes that they cannot pay? Interest and penalties accrue and the IRS levies against them. What a nightmare. Thus, before seeking to decrease withholding – and therefore decrease the taxes paid in on the settlement or severance – it is best for the client to get tax advice from a professional.

Another way to try to reduce, at least somewhat, the federal withholding on a large lump-sum payment is to get the employer to agree to set withholding at that year's "supplemental" or bonus rate, which is a flat tax rate for payments under $1 million. For 2024, the supplemental rate is 22%. If the parties agree to this, it should be captured in the agreement (sample language later in this article!).

Are there any tax implications relating to confidentiality provisions?

In 2018, in the wake of the #MeToo movement, we were all talking about the "Weinstein" amendment, which did not allow employers to take a tax deduction for any settlements of sexual harassment claims where there was a confidentiality, or non-disclosure, clause. This rule is still in place however, it is not discussed as much these days. Now, the "hot topic" with confidentiality arises from recent rulings by the National Labor Relations Board – a subject for a different article!

Should we be afraid of Section 409(A)?

The general rule is that severance benefits are a form of deferred compensation subject to Section 409A unless an exception or exemption applies. There are timing issues that need to be reviewed and adhered to in order to avoid the implications of 409A.

There are two main ways in which separation pay can be structured consistent with Section 409A. First, the separation pay can be structured to avoid Section 409A – meaning structured so that it does not fit the definition of deferred compensation subject to Section 409A at all. This can be done by structuring the payments to fit within one of the following exceptions to what is considered deferred compensation:

- The short-term deferral exception, or
- The separation pay safe-harbor exception.

Under the short-term deferral exception, payments made not later than two and one-half months after the end of the year in which a "substantial risk of forfeiture" lapses (or stated another way, "after the right to payment vests") are not deferred compensation. On the other hand, the separation pay safe harbor is available for separation pay that is paid only in the case of an involuntary termination and that does not exceed, in the aggregate, the lesser of twice the employee's annualized compensation for the previous calendar year, or twice the compensation limit in IRC §401(a)(17). In 2024, the limit is $345,000, so twice would be $690,000.

While it is not likely that Section 409(A) would be implicated in most severance arrangements, employee counsel should seek tax advice on this issue – or advise the client to do so – if it does appear that it could arise.

Is there anything we should be telling our clients about Medicare and Social Security taxes?

Social Security and Medicare deductions, and the employer's match of these deductions, (FICA) can become an issue for high-wage earners or for settlements in which the wage payment is large. Social Security is deducted – and matched – on wages that do not exceed a cap that increases each year. In 2024, the cap is $168,000 and will increase to $174,900 for 2025. This means that, if a client receives a severance or wage payment in a settlement that exceeds the cap amounts, Social Security will be deducted only from wages paid, up to the capped amount.

While Medicare has no cap or threshold, like Social Security does, there is a "surtax" that can be due on annual wages of $200,000 or more for single filers. Generally, Medicare tax is a flat 1.45% of wages. However, for amounts that exceed $200,000, an "extra" .9% is owed. Employers are responsible for deducting and remitting any surtax owed.

💡 ***Practice Pointer***: If the client wants to avoid the .9% surtax, and depending on other circumstances, the parties could agree to spread out the payments over two years to keep the payments below the threshold for the surtax. Similarly, if the client wants to maximize Social Security contributions, a large payment spread out over two tax years, where the payments do not exceed that year's cap, would ensure maximum contributions.

What about tax indemnification? If I represent an employer, do I need it? If I represent an employee, should I fight about it?

Employers generally insist on tax indemnification to ensure they do not have an issue later on with the designation of any amount that is paid to the plaintiff/claimant that is not characterized as wages and that is not treated like payroll.

Employee-side attorneys often resist tax indemnification but, with proper drafting, there are ways to compromise here that do not harm the client and should not interfere with the settlement or severance arrangement. Employees can agree to indemnify a former employer if some liability arises based on *how the employee treats the payments for tax purposes*.

However, employees should never indemnify a company for the employer share of FICA taxes. For example, if the IRS determines that the amount allocated to emotional distress should have been treated like wages, the employee will be on the hook for the withholding that was not paid, but the employer will be on the hook for its share of FICA (i.e. Social Security and Medicare matching taxes).

Here is sample language for an agreement that represents both sides' interests fairly:

> The parties agree to indemnify and hold each other harmless for any tax liability, together with any interest or penalties assessed thereon, which Employee and/or RELEASEES may be assessed by the United States Internal Revenue Service, or any state or local department of taxation, **arising from the other party's tax treatment of the payments made to Employee** pursuant to this Agreement, with the exception of the employer's portion of any applicable withholding, **for which the Company shall be responsible**.

Here is sample language to include in the payment provisions of settlement and severance agreements.
Going back to the hypotheticals above, consider Mary's settlement scenario, where there are three checks, one for lost wages, one for emotional distress and a separate check to Mary's legal counsel. The $100,000 payment to Mary is allocated 50/50 to lost wages and emotional distress and the attorney fees are $40,000.

Here is how this allocation and tax reporting is reflected in the language of the settlement agreement:

> In consideration for this Agreement, the Company shall pay Employee the total sum of One Hundred Thousand Dollars and Zero Cents ($100,000.00) ("Settlement Sum"). The Settlement Sum shall be paid as follows:
>
> i. One check shall be made payable to Employee in the amount of Thirty Thousand Dollars and Zero Cents ($30,000.00), less required withholdings, and representing alleged wage damages for which the Company shall issue Employee an IRS Form W-2;
>
> ii. One check shall be made payable to Employee in the amount of Thirty Thousand Dollars and Zero Cents ($30,000.00), with no withholdings, representing alleged non-wage compensatory damages for which the Company shall issue Employee an IRS Form 1099-MISC, with this amount reported in box 3; and
>
> iii. One check shall be made payable to Employee's Counsel in the amount of Forty Thousand Dollars and Zero Cents ($40,000.00), representing attorney's fees and costs for which an IRS Form 1099-MISC shall be issued.

If the parties agree that the employer will tax the wage portion of the settlement at the supplemental rate, here is a variation in the language to use:

> One check shall be made payable to Employee in the amount of Thirty Thousand Dollars and Zero Cents ($30,000.00), less required withholdings, **with federal withholding set to the supplemental rate**, and representing alleged wage damages for which RELEASEES shall issue Employee an IRS Form W-2.

Shifting gears to the severance scenarios, the issue here is whether the severance will be paid lump sum or periodically, in accordance with the company's payroll schedule. Here is language for a severance that is paid out over time, and where the employer pays the COBRA premiums directly:

> The Company agrees to pay Employee 26 weeks of special separation pay ("Severance Payments") in the total amount of One Hundred Twenty-Five Thousand Dollars and Zero Cents ($125,000.00), less legally required deductions. The Severance Payments will be paid bi-weekly, in a manner consistent with the Company's payroll schedule.
>
> The Employee's coverage under the Company's medical, dental, and vision plans will continue through the Severance Period. During this time, and assuming that Employee makes a timely election for continuation coverage under COBRA, the Employer will pay the Employee's COBRA premiums directly to the COBRA administrator.

Here is language for a situation where the employee pays the COBRA premiums herself and seeks reimbursement from the employer:

> The Company agrees to pay Employee 26 weeks of special separation pay ("Severance Payments") in the total amount of One Hundred Twenty-Five Thousand Dollars and Zero Cents ($125,000.00), less legally required deductions ("Severance Payments"). The Severance Payments will be paid bi-weekly, in a manner consistent with the Company's payroll schedule.
>
> Should the Employee elect to continue her healthcare coverage under COBRA, Employee shall pay the COBRA premiums for which the Company shall reimburse her, upon receipt of proof that the payments were made.

At the end of the day, although most employment lawyers are not tax lawyers or tax professionals, it is imperative that we at least recognize the tax issues that can arise in our cases and, if we are unable to provide our clients with at least some advice on these matters, it is incumbent upon us to get to the hands of a competent tax advisor, whether an attorney, an accountant – or both!

About the Authors

Christina M. Royer is a partner with Employment Law Partners LLC located in Independence, Ohio.

Lesley A. Weigand is a partner with the firm of Stark & Knoll Co. LPA located in Akron.

Faith C. Whittaker is a partner with the firm of Dinsmore & Shohl LLP in Cincinnati.

A Message from the Chair

Thanks as always to the newsletter committee for another collection of timely topics from a variety of authors. Please contact Robert Fekete if you would like to write for the newsletter or otherwise assist with this great section resource.

Many of us are catching a breath a bit after a successful 61st annual Midwest Labor & Employment Law Conference, the section's biggest endeavor of any year. Which makes it a good time to take stock of all members' interests and thoughts, so please reach out to me if you have any thoughts or interests that remain untapped! We would love to get you involved.

Bill Nolan
Ohio Bar Labor and Employment Law Section Chair

About *Labor and Employment News*

"Labor and Employment News" is produced by the Ohio State Bar Association Labor and Employment Law Section.

For more information about "Labor and Employment News," contact editors Robert Fekete, State Employment Relations Board (Columbus), at robert.fekete@serb.ohio.gov and Daniel Sabol, State Employment Relations Board (Columbus), at daniel.sabol@serb.ohio.gov.

Articles published in this newsletter reflect the views and opinions of the writers and are not necessarily the views or opinions of the Ohio Bar Labor and Employment Section. Publication in Labor and Employment News should not be construed as an endorsement by the section or the bar.

For information about other Ohio Bar committee and section newsletters, contact Content Editor Annie Yamson at ayamson@ohiobar.org.

Designed by Dan Petrovski.

Labor & Employment Section Council Executive Committee

Bill Nolan, Chair (bill.nolan@btlaw.com)
Liz Crosby, Vice-Chair (crosby@buckleyking.com)
Chris Royer, Secretary & Treasurer (chris@employmentlawpartners.com)
Donald Collins (donald.collins@collinsarbitration.com)
Theresa Nelson (tnelson@brickergraydon.com)
Sara Jodka, Immediate Past Chair (sjodka@dickinson-wright.com)

Labor & Employment Section Council Committee Chairs

Advanced Employment Law CLE
- Carl Muller (carl.muller@tuckerellis.com)
- Charles Warner (cwarner@porterwright.com)

Fundamentals of Labor & Employment Law CLE
- Shannon Wahl (swahl@martinbrowne.com)

Communications Committee
- Robert Fekete (robert.fekete@serb.ohio.gov)
- Daniel Sabol (daniel.sabol@serb.ohio.gov)
- Rachel Reight (rreight@bmcolawfirm.com)
- Matthew Crawford (matthew.crawford@cincinnati-oh.gov)

Midwest Labor & Employment Law Conference
- Kelly Myers, Co-Chair (kmyers@fmr.law)
- Bill Nolan, Co-Chair (bill.nolan@btlaw.com)
- Stuart Torch, Co-Chair (stuart@employmentlawpartners.com)

NLRB/NLRA CLE
- Jim Burkhardt (burkhardtjim1@gmail.com)

Public Sector CLE
- Don Collins (donald.collins@serb.state.oh.us)

Webcasts
- Joelle Khouzam (jkhouzam@bricker.com)

Editors' Note—Guest Columns

Anyone interested in submitting an article for publication in the Labor and Employment Law Section newsletter are encouraged to contact the newsletter editors, Robert Fekete (Columbus) and Daniel Sabol (Columbus) by email at robert.fekete@serb.ohio.gov and daniel.sabol@serb.ohio.gov.

Articles should not have appeared in other publications, but works appearing only on your employer's website or client newsletter will be considered with the employer's approval.

Articles will typically range between 1 to 10 pages but works outside of those limitations will be considered. The editors reserve the right to select articles for publication, to decline to publish any article and to require the editing of an article to make it appropriate for publication.