Ensuring Compliant Per Diem Practices in Aviation

How staffing firms and their customers can minimize legal risk

Kirk Hardy
Aerotek Director of Business Development

Aerotek®
Our People Are Everything.™

When used correctly, per diem payments are a useful way to reimburse expenses that employees incur when performing their jobs. However, the federal government sets strict guidelines governing when and how per diem payments can be implemented. Violating these guidelines puts staffing companies, their customers and their employees at risk for negative consequences including tax evasion implications, misclassification of wages, tax audits and workers' compensation issues.

This white paper will outline how staffing companies, their customers and their employees can implement and/or participate in a legally compliant per diem program to mitigate risk and governmental scrutiny.

Aviation companies that use per diem payments risk being hit with substantial financial penalties if they don't implement them properly — a risk that's present even when companies use a staffing firm.

The U.S. Labor Department (DOL) and the Internal Revenue Service (IRS) set strict guidelines governing when and how to implement per diem payments. Improper allocation of per diem payments creates increased risk for exposure to substantial financial costs for all stakeholders. For example:

"Louisiana Company Agrees to Pay $2 Million in Back Wages"

WASHINGTON EXAMINER

In 2013, a Louisiana labor services firm was found to have miscalculated per diem payments to temporary workers and contractors by impermissibly excluding per diem wages when calculating employees' overtime premiums, resulting in underpayments of nearly $2 million. Per the terms of a Fair Labor Standards Act of 1938 (FLSA) settlement, the firm was ordered to pay that amount to the affected employees in back wages.

Whether due to ignorance of the law, intentional wrongdoing or some other factor, the services firm exposed its customer to the threat of legal action and other negative reputational impacts.

So what information do staffing firms and their aviation industry customers need to know in order to stay on the right side of the law when using per diems?

Avoiding Per Diem Abuse

Per diem abuse is reported to be widespread in the aviation industry, whether because of the high demand for these workers or low compliance on the part of some vendors. Some vendors may avoid compliance with per diem guidelines in order to present customers with a lower bill rate, which they achieve due to their lowered taxable wage base and employer statutory costs. This allows the vendor to appear as a less expensive option to the customer while in fact they are greatly inflating their profit margins. Although it offers benefits to the vendor, it increases risk for the customers and creates longer term negative impacts on the contractors.

At any rate, the last few years have seen regulatory agencies ramp up their activities, strictly enforcing regulations and making changes that will better protect the wages and per diem payments to employees.

Risks to Staffing Agencies & Customers

A broad use of per diem payments may seem like an attractive practice to employers because they can deduct per diem amounts as a business expense. Yet prudent company management and best practices recommend following the IRS guidance to the letter.

"Companies break the law when they label part of a worker's regular wages as per diem expense reimbursement instead of wages," notes Wage and Hour Division Administrator Davie Weil. In doing so, they also gain an advantage over their competitors. "Illegal per diem hurts law-abiding employers, defrauds local, state and federal governments and cheats all of us who pay increased taxes as a result."

Improper per diem practices leave the staffing company and its customer vulnerable to a significant amount of risk, in addition to impacting the employee. If the fines levied are substantial, it could be enough to put an employer out of business. Other risks include:

Wage re-characterization audit: Misclassification of wages can lead to a wage re-characterization audit, which would assess whether an employer was offering a significantly lower comparable wage coupled with a substantially higher per diem rate.

Tax evasion charges: Per diem expenses are non-taxable, intermingling wages and per diem payments can give a company the appearance of evading taxes.

Back payment of wages: If the government determines that wages, including overtime wages, were underpaid, employees will be entitled to back payment of those wages.

Incorrect payroll-related reporting: Payroll tax deductions such as the Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), State Unemployment Tax Act (SUTA) and Medicare are based on an employee's earned wages, incorrect categorizations of earned wages can cause payroll taxes to be underpaid. Overtime costs, too, can be miscalculated, leading to workers missing out on earned compensation. Further, workers' compensation insurance coverage could be based on incorrect figures.

Reputational damage: The DOL has a vested interest in promoting its successful actions against offending companies. Any finding of wrongdoing could result in unfavorable media coverage that could damage a company's hard-earned reputation, as well as impacting the perception of the existing workforce and prospective applicant pool.

Workplace disruption: Wage mischaracterization can also create workplace disruption and distrust when workers are paid different effective amounts due to the incorrect characterization. When a staffing company is involved, the disruption can include attrition by direct workers who quit the employer and join a staffing agency to earn the higher effective wage, which can lead to a negative work atmosphere, quality issues and a loss of valuable talent.

Ban on using per diem: The government reserves the right to refuse offending staffing firms and their customers the right to utilize per diem programs in the future.

Risks to Employees

Per diem payments are also attractive to employees, since they are not reported on a worker's W-2 statement and are non-taxable. However, allowing an employer to incorrectly pay per diem versus wages exposes workers to the potential of an IRS audit and both short- and long-term risk, including having to pay back taxes and interest as well as any fees or penalties.

"Workers don't often complain about receiving per diem pay in place of regular wages because they believe they make more money being paid this way," said Wage and Hour Division's Weil. "The truth is these workers are losing out. They are not getting all of the short- and long-term benefits their employer owes them." Other risks include:

Overtime compensation: Incorrectly calculated wages impact the amount an employee earns when accruing overtime pay, possibly leading to underpayment of wages.

Workers' compensation: If an employee is injured on the job, incorrectly reported wages could lead to reduced eligibility for workers' compensation. Since the benefit is calculated on taxable wages, any payments classified as expenses would reduce the amount for which the employee would be eligible.

Unemployment benefits: Incorrect per diem payments could also have a significant impact on a former employee seeking unemployment benefits. Since this benefit is also calculated on taxable wages, the amount for which the employee is eligible could be reduced. This can have a disproportionate effect in the aviation industry, where it is very common for contract employees to be unemployed between project assignments.

Social security and retirement income: The long-term impact of reduced taxable wages cannot be overstated. Social security is another area where an employee could suffer reduced eligibility, where social security contributions don't correspond with actual hours worked. It also reduces the opportunities for employees to make contributions to their retirement plans.

Best Practices

So how can staffing agencies and their customers ensure they are in compliance with IRS and other requirements? At Aerotek, we always follow and recommend these best practices:

› Don't split wages. The IRS recommends that employers calculate wages and per diem separately in order to ensure that wages are not misclassified.

› The employee should be paid the minimally required taxable wage whether or not he or she is on a travel assignment.

› Companies and employees alike should maintain documentation of all applicable per diem expenses.

› Customers should require all staffing firms to break out per diem payments as a separate line item on each invoice.

› If excess per diem payments are made to the employee, ensure that the per diem payments were consistent with the incurred expenses pursuant to an accountable plan and that any deficient or excess payments be properly accounted for with regard to the company and/or employee.

Recommendations for Reducing Risk

When you work with a staffing agency, ensure that any staffing firm:

› Adheres to the highest standards of compliance.

› Provides complete transparency into the process so that you can accurately assess your risk.

› Breaks out per diem payments on each invoice.

Conclusion

Managing per diem risk is all about the health of your company in the long run versus cutting corners to achieve short-term benefit. Given the risks inherent in non-compliance, your company would be better served by a policy that establishes and maintains procedures that properly classify wages versus expenses and ensures you avoid any potential negative consequences.

***Kirk Hardy**, Director of Business Development for Aerotek, specializes in the aerospace and defense industries. He has over 20 years of experience in mergers and acquisitions, high-level sales strategy and business development across multiple product lines.*

ABOUT AEROTEK Our People Are Everything. For more than 30 years, Aerotek® Inc. has distinguished itself as a leader in recruiting and staffing services by having a deep understanding of the intersection of talent and business. As a strategic partner to more than 18,000 clients and 300,000 contract employees every year, Aerotek's people-focused approach yields competitive advantage for its clients and rewarding careers for its contract employees. Headquartered in Hanover, Md., Aerotek operates a network of over 250 non-franchised offices with more than 6,000 internal employees dedicated to serving our customers. To learn more, visit: **Aerotek.com** | **1-888-AEROTEK** | An Allegis Group Company