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# Court: UC Board's 'Net Income' Calculation Unfair to Some Claimants

The court said the state Department of Labor & Industry regulation establishing that calculation method was "identical"—save for a single Oxford comma—to a Bureau of Employment Security regulation that had been invalidated by the Pennsylvania Superior Court a few years earlier.

By Zack Needles | March 15, 2018

In a decision that could have implications for Uber and Lyft drivers, among others, the Commonwealth Court has invalidated the Unemployment Compensation Board of Review's method for calculating claimants' net income from sideline businesses, finding that it improperly reduces benefits for claimants whose part-time businesses sell services rather than goods.

A three-judge panel of the court, in a published opinion



([http://www.pacourts.us/assets/opinions/Commonwealth/out/748cd17\\_3-12-18.pdf#search=%22sideline%22](http://www.pacourts.us/assets/opinions/Commonwealth/out/748cd17_3-12-18.pdf#search=%22sideline%22)) in *Lerch v. Unemployment Compensation Board of Review*, also said the state Department of Labor & Industry regulation establishing that calculation method, adopted in 1968, was “identical”—save for a single Oxford comma—to a Bureau of Employment Security regulation that had been invalidated by the Pennsylvania Superior Court a few years earlier.

The regulation at issue, found at 34 Pa. Code, Section 65.121, describes the formula for calculating a claimant’s net income from a sideline business as “‘gross income’ from sales and services” minus “the cost, if any, of goods sold,” including “the total cost of merchandise, cost of labor, and cost of material and supplies.”

The problem with that formula, the panel said, is that it unfairly ignores the fact that claimants with sideline service businesses do not sell “goods” but likely incur other necessary expenses that reduce the bottom line.

“The department’s regulation so severely limits the deductions from gross income of a sideline service business as to eliminate any distinction between gross and net income,” said Judge Robert Simpson, writing for the panel. “However, a claimant with a sideline business selling goods can deduct the cost of those goods and related expenses. As a result, a claimant with a sideline service business may lose some or even all UC eligibility, even though the sideline business operates at a loss, while a similarly situated claimant with a sideline sales business does not.”

Simpson was joined by Judge Michael H. Wojcik and Senior Judge Bonnie Brigance Leadbetter.

In *Lerch*, according to Simpson, claimant Valerie Lerch’s sideline event-planning business generated gross revenue of \$27,510 in 2015 and \$15,635 in 2016. While her federal tax return for 2015 reflected a deduction of \$1,380 for supplies, it did not reflect any deductions for the cost of goods sold because her business offers only services. Lerch did, however, deduct a number of other business expenses, including the cost of renting facilities for her clients’ events. Her business operated at a net loss of \$5,767 in 2015 and \$7,857 in 2016.

Lerch applied for UC benefits in November 2016 after leaving her full-time job and did not increase the amount of time she was spending each week on her sideline business, Simpson said.

The board, however, reduced Lerch's weekly UC benefit by \$506, based on its calculation of net income from her sideline business, which deducted only the cost of supplies from the business' gross income and failed to take into account other operating expenses like venue rentals, according to Simpson.

Lerch appealed, arguing that the board's formula for determining her sideline business' net income was unreasonable. She also argued that the formula was derived from Section 65.121, which should be declared invalid because it is identical to Bureau of Employment Security Regulation 120, which the Superior Court invalidated in *Department of Labor & Industry v. Unemployment Compensation Board of Review (Springer)* and *Department of Labor & Industry v. Unemployment Compensation Board of Review (Vitolins)*, companion cases decided on the same day in 1964.

In those cases, the Superior Court held that the Department of Labor & Industry did not have the power to adopt its own definition of "net earnings." Instead, for the purposes of determining UC benefit deductions, the term "net earnings," which is not defined in the Pennsylvania Unemployment Compensation Law, must have its plain everyday meaning: the earnings of a business that remain after deducting expenses.

In *Lerch*, the board argued that the Superior Court's rulings in *Springer* and *Vitolins* lacked persuasive value because they predated Section 65.121, but the Commonwealth Court disagreed.

"Regulation 120 and Section 65.121 are identical," Simpson said. "By logical extension of the board's argument, whenever a court strikes down an administrative regulation, the agency can defy that judicial ruling simply by re-promulgating and renumbering the same regulation, without any intervening change in the enabling statute."

While the board argued Section 65.121 was a valid and binding legislative regulation adopted pursuant to the department's rulemaking power as a state agency, the panel found that it was merely an interpretive rule because it was improperly adopted after the Superior Court had struck down a previous, identical regulation.

"The board does not point to any alteration in Section 65.121 that would distinguish it from Regulation 120," Simpson said. "Therefore, once the Superior Court held in *Vitolins* and *Springer* that defining 'net earnings' by regulation was beyond the department's authority, the department was not free to simply re-promulgate the same regulation without any intervening change in the authorizing statute, Section 402(h) [of the UC Law]."

Lerch's attorneys, Daniel Berlin and John Stember of Stember Cohn & Davidson-Welling in Pittsburgh, said the board has not applied Section 65.121 consistently over the years, but this ruling could still have broad impact given today's economy, where online marketplaces and ride-sharing companies have made it easier than ever for the average person to have a sideline business where expenses are incurred but not necessarily for physical goods.

"We're seeing more and more clients who have their wage employment but they're also driving Uber or selling things on Etsy or eBay," Berlin said.

Indeed, as Berlin pointed out to the court in *Lerch* and Simpson mentioned in a footnote in the panel's opinion, the Commonwealth Court has already had a brush, earlier this year, with the issue of how to calculate net earnings for Uber drivers.

“This court implicitly disregarded Section 65.121 in *Lowman v. Unemployment Compensation Board of Review* ... in which we noted that the calculation of the claimant’s part-time ‘earnings’ as an Uber driver needed to take into account not only what Uber paid him, but his associated expenses,” Simpson said.

A spokesperson for the department could not be reached.

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