

## Classification Conundrum



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**Resource Type:** Risk eNews

**Topic:** HR Risk and Employment Practices

Updated: September 24, 2019

### Avoiding Potentially Costly Employee Classification Errors

Across the country, many nonprofit leaders struggle with the question of whether or not they have properly classified their staff members as either “exempt” or “non-exempt” workers. The Department of Labor’s Fair Labor Standards Act (FLSA) can often be confusing, and additional clarification on the nuances of the law, understanding the FLSA’s parameters and properly classifying employees is achievable for all nonprofit leaders.

Even with additional clarification and guidance from the Department of Labor, wage and hour violations will likely continue to be a lurking risk in many nonprofits. Unlike risks that pose obvious threats to an organization’s well-being, it is very difficult for even a well-intentioned CEO to spot compensation errors that could jeopardize the fiscal health of the nonprofit. As long as the nonprofit meets its payroll obligation every pay period and employees voice few or no complaints about their pay stubs, wage and hour violations can often go unnoticed.

### Common Wage and Hour Mistakes

Wage and hour investigations by the Department of Labor indicate that employers fail to pay required overtime when they misclassify employees who were really “non-exempt,” as if they were “exempt.” The true danger in this practice lies in the fact that if the government’s position is correct, the nonprofit will not only owe back overtime wages and withholding taxes, but also penalties — often money that the nonprofit had not budgeted and is generally not available out of the operating budget. Other common but risky practices include:

- disciplining exempt employees by docking pay in periods of less than a full day, which results in the conclusion that the employer was paying the employee by the hour, rather than on a salary basis, thus creating liability for overtime;
- failing to treat mandatory work-related meetings and training sessions as hours worked;
- not providing “duty-free” lunches for non-exempt staff — keep in mind that if you’re requiring an employee to answer phones or perform any task during lunch you have not provided a true lunch break;
- not requiring non-exempt employees to clock in and out for lunch — some employers automatically deduct one hour or one-half hour from an hourly employee’s workday, regardless of whether the employee actually takes a lunch break;

- not paying work preparation time or travel time that is legitimately part of the job;
- not reimbursing employees for employment-related expenses (e.g., mileage or required extra insurance premium for auto coverage the employer requires that exceeds the state's minimum limits);
- not providing all wages due at termination. Most states have "final paycheck" laws that require prompt payment of a departing employee's final check that may include payments for accrued vacation time; and
- erroneously classifying employees as independent contractors

An employer that commits any of the violations described above may be liable for unpaid wages, statutory penalties, interest, and attorneys' fees for all affected employees. To avoid exposure to financial penalties and an enormous headache, every employer should conduct a thorough review of wage and hour practices and eliminate any non-compliant practices.

## Step by Step Assessment

In this section, the process for determining whether an employee should be classified as exempt versus non-exempt has been simplified into two basic steps: (1) the salary level and salary basis tests, and (2) the duties test. If you're responsible for developing job descriptions or classifying employees for your organization but you don't fully understand these tests, there's a good chance your nonprofit has made some potentially costly missteps in classifying employees.

Keep in mind that it is never appropriate to classify employees based solely on their salary, rank, background, or the nonprofit's desire to avoid overtime pay. Thus, carefully reviewing all employee positions to determine whether an employee is correctly classified is very important. If a position has been classified incorrectly, consult with legal counsel about the process for changing the classification and reducing the exposure facing your organization.

### STEP 1: DOES THE POSITION MEET THE SALARY LEVEL AND SALARY BASIS TESTS?

Salary Level and Salary Basis Tests — Current FLSA regulations provide that a position for which you pay more than \$455 per week may be exempt from overtime, but only if the position is paid on a salary basis. An employee whose annual earnings are \$23,660 or less—regardless of whether they are paid on a fixed, salary basis—must be classified as non-exempt. **Note: Beginning January 1, 2020, the new threshold is \$35,568 or \$684 per week.**

If a position pays more than \$455 per week (\$23,660 annually), make certain the employee is paid on a "salary basis" before proceeding to Step 2. Remember, the title, position, authority or role of the employee are of no consequence in determining whether a position meets the salary level and salary basis tests.

To help nonprofit organizations understand their options for compliance, the Department of Labor offers several resources, including [Fact Sheet #17A](#) and [Handy Reference Guide to the Fair Labor Standards Act](#).

According to the Department of Labor, "Being paid on a 'salary basis' means an employee regularly receives a predetermined amount of compensation each pay period on a weekly, or less frequent, basis. A sometimes confusing issue for employers is that the predetermined amount cannot be reduced because of variations in the quality or quantity of the employee's work. Subject to certain exceptions outlined by the Department of Labor, an exempt employee must receive the full salary for any week in which the employee performs any work, regardless of the number of days or hours worked. Exempt employees do not need to be paid for any workweek in which they perform no work.

If your nonprofit makes deductions from an employee's predetermined salary due to variances in workload, that employee is not being paid on a true 'salary basis.' If the employee is ready, willing and able to work, you may not make deductions from their pre-determined pay simply because work is not available. For information on the circumstances under which a salaried employee may receive less than his or her full salary for any week in which the employee performs any work, see [DOL Factsheet #17G](#).

## **STEP 2: DOES THE POSITION MEET THE DUTIES TEST? WHICH EXEMPTION CATEGORY APPLIES?**

Duties Test — Although the duties test was not revised in the 2016 rule, it is more complicated than the salary level and salary basis tests. It provides that a position that is eligible for exempt status because it meets the salary level and salary basis tests can only be classified as exempt if the position's duties meet the parameters of an allowed exemption category. The most common exemption categories are executive, administrative and professional. These are discussed in the next few sections. Keep in mind that other exemption categories, such as technical and creative, exist as well. Consult the [Wage and Hour Division website](#) for information about other exemptions.

### **Executive Exemption**

[Fact Sheet #17B](#) offers information on the exemption for executive employees under the FLSA. Eligibility for the executive employee exemption is limited to positions:

- Whose primary duty is managing an enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- Whose customary duties include supervising the work of at least two or more other full-time employees; and
- Whose authority includes the ability to hire or fire other employees, or whose recommendations as to the change of status of other employees are given weight.

**Classification Tip:** Some nonprofit managers believe that anyone who supervises two or more employees is automatically "exempt." As the section above indicates, this is a misconception about the regulations.

### **Administrative Exemption**

Eligibility for the administrative employee exemption is limited to positions:

- Whose primary duty is the "performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers"; and
- Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

**Classification Tip:** A key to properly applying the Administrative Exemption is understanding the phrase "discretion and independent judgment with respect to matters of significance." Some nonprofits misstep by claiming that all (or most!) employees use discretion and judgment. A closer look reveals that the opposite is generally true: a minority of employees at the typical nonprofit use discretion and judgment. When an employee performs work that involves following techniques or procedures, they are applying skill to the task. When an employee is expected to depart from or change procedures without supervisory intervention they are probably using discretion and judgment.

### **Professional Exemption**

Positions that may be exempt under the professional exemption category include those where:

- The primary duty is work requiring advanced knowledge, defined by DOL as "work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment";
- The advanced knowledge required for the position is in a field of science or learning; and
- The advanced knowledge required for the position is acquired through a "prolonged course of specialized intellectual instruction."

Some employees may qualify for the "creative professional employee exemption." This exemption applies to positions that meet the salary level and salary basis tests AND where the position's "primary duty" is the "performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor."

**Classification Tip:** Some nonprofit leaders regard all of their staff as "professionals" and therefore believe the

professional exemption applies to all positions. This is rarely true. The requirements listed above should make it clear that the professional exemption applies in only rare instances. While it may be good for morale to refer to staff members as “professionals,” remember that this term is interpreted narrowly in wage and hour regulations and a staff member who is regarded as a professional may be non-exempt and therefore eligible for overtime pay.

## **Final Thoughts**

It is important to realize that to be exempt from overtime pay requirements, an employee must not only meet the federal test for exempt status, but must also meet any state requirements that may be more stringent than the federal exemptions. Review the wage and hour provisions in your state by visiting your state department of labor website. Additional state-by-state information can be found on the Department of Labor website. Before changing the classification of any employee positions in your nonprofit, consult an experienced employment attorney licensed in your state who can advise your nonprofit about the best way to proceed.

The Department of Labor also offers a clickable map of the Minimum Wage Laws, as well as a table showing state minimum wage rates and daily/weekly thresholds for premium pay. To learn more about the minimum wage laws in your state, visit: [www.dol.gov/whd/minwage/america.htm](http://www.dol.gov/whd/minwage/america.htm) and click on your state. Keep in mind that where Federal and state laws have different minimum wage rates, the higher rate applies. As you'll see on the map, five states have NO minimum wage law, but 30 states/territories have minimum wage rates that are HIGHER than the Federal rate.