

Exempt or Non-Exempt? The Ten Most Common Employee Classification Pitfalls Faced by Nonprofits

Tuesday, January 8, 2013
12:30 p.m. – 2:00 p.m. EST

Venable LLP
Nonprofit Organizations Practice
Washington, DC

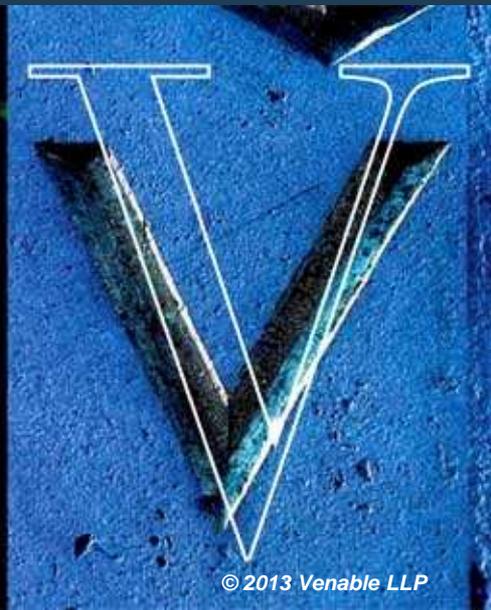
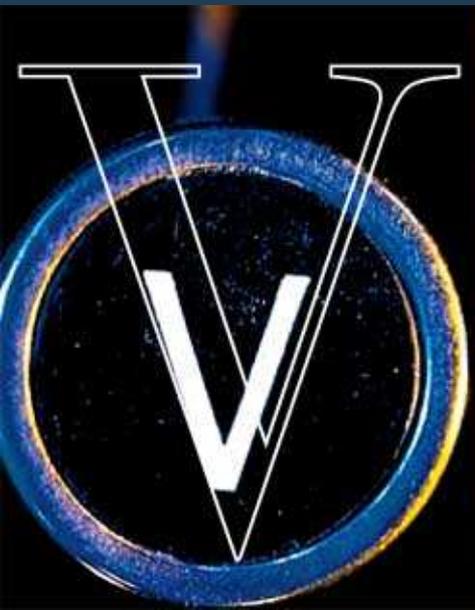
Moderator:

Jeffrey S. Tenenbaum, Esq., Venable LLP

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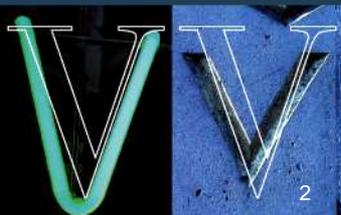
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Upcoming Venable Nonprofit Legal Events

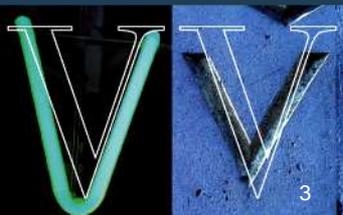
February 12, 2013 - [Top Ten Federal Grant and Contract Pitfalls for Nonprofits](#)

March 13, 2013 - [Preparing an Online Social Media Policy: The Top Ten Legal Considerations for Your Nonprofit](#)



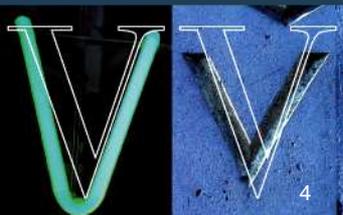
Overview

- **How to find and fix common misclassification errors**
- **Topics covered today:**
 - Common exemptions from the FLSA
 - Independent contractors
 - Commissioned salespersons
 - Seasonal employees
 - Computer professionals
 - The myth about salaried employees
 - The importance of written job descriptions



Overtime Basics

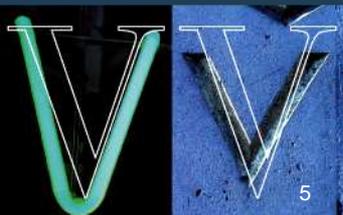
- **General Overtime Rules under the FLSA**
 - 40-hour workweek / 1½ times the regular rate of pay
- **Common Exemptions from the FLSA:**
 - Executive Exemption
 - Administrative Exemption
 - Professional Exemption
 - Computer Professional Exemption
 - Seasonal Employee Exemption
 - Highly Compensated Employee Exemption
- **Two Tests to Determine if Exemption Applies:**
 1. Duties Test
 2. Salary Test



Exemption Application

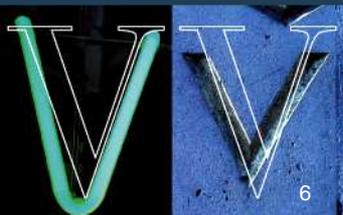
■ Duties Test:

- Asks about the “primary duty”
- Factors considered include:
 1. Relative importance of exempt duties
 2. Amount of time performing exempt duties (but not necessarily majority of time)
 3. Relative freedom from supervision
 4. Wages paid to other employees for non-exempt work



Exemption Application (cont.)

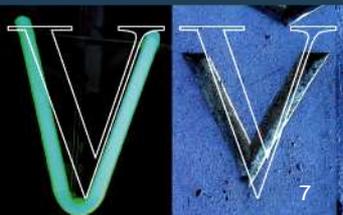
- **Salary Test:**
 - Requirements
 - Paid \$455 per week (\$23,660 per year)
 - Paid on a salary basis
 - Pay not subject to reductions because of quantity or quality of work
 - Ready, willing, and able to work



Executive Exemption

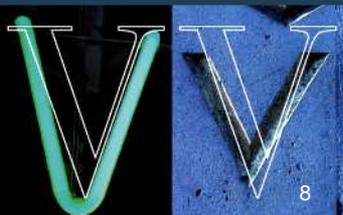
■ Duty Test

- Primary duty is the management of the enterprise or a department within the enterprise
- Regularly directs the work of two or more other employees
- Has authority to hire or fire employees, or alternatively, management will heed his/her recommendations to hire or fire employees



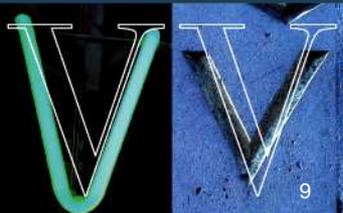
Executive Exemption (cont.)

- **Whether the Primary Duty Is Management**
 - Interviewing, selecting, and training employees
 - Adjusting rates of pay or work hours
 - Planning and directing work tasks
 - Maintaining documents used for performance evaluations
 - Conducting employee reviews
 - Addressing workplace complaints or grievances
 - Budgetary decisions and oversight
 - Monitoring or implementing legal compliance measures
 - Ensuring employee safety



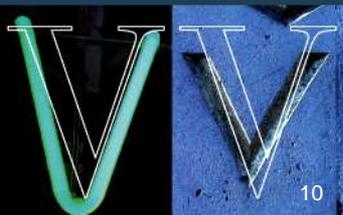
Executive Exemption (cont.)

- **Supervision of Subordinate Employees**
 - Regularly directs the work of at least two employees
 - The subordinate employees are full-time, or, alternatively, the part-time employees work at least 80 combined hours per week



Executive Exemption (cont.)

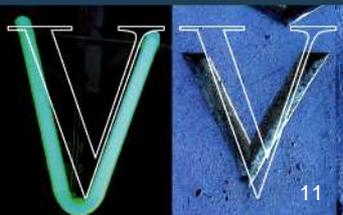
- **Authority to Hire or Fire Employees**
 - The employee does not need unilateral authority
 - Relevant factors
 - Are such decisions or recommendations part of the employee's job responsibilities?
 - How often are such decisions or recommendations made by or requested of the employee?
 - How often does the employer rely upon the recommendation of the employee?
- **Salary Test**
 - \$455 per week?
 - Salaried?



Administrative Exemption

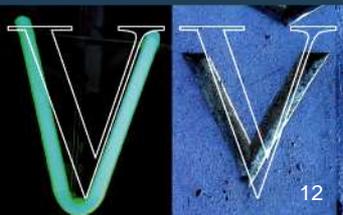
■ Duty Test

- The employee's primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or its clients/customers
- The employee's primary duty must also require the exercise of discretion and independent judgment with respect to matters of significance



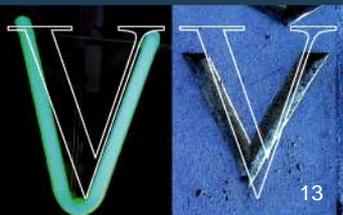
Administrative Exemption (cont.)

- **Whether Duties Directly Related to the Management or General Business Operations**
 - Duties related to running or servicing of the enterprise instead of manufacture, sales, or retail
 - E.g., finance, auditing, budgeting, purchasing, advertising, human resources, quality control, legal and regulatory compliance, employee benefits, labor relations, and health and safety
 - Duties must be of substantial importance to the management or operation of the employer's enterprise or the employer's clients/customers
 - E.g., employees consulting for the employer's clients/customers
 - Indispensability of the job is not dispositive



Administrative Exemption (cont.)

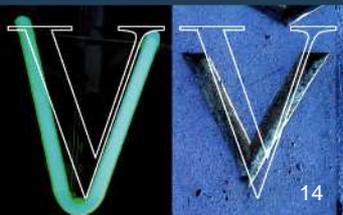
- **Exercise of Discretion and Independent Judgment**
 - The employee chooses between two or more possible courses of conduct
 - The choice is free from immediate direction or supervision on matters of significance
 - The employee's decisions may still be reviewed at times
 - The decisions may be recommendations for action rather than direct action
 - Merely following procedures is not sufficient



Administrative Exemption (cont.)

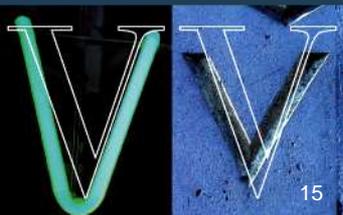
■ Matters of Significance

- Major assignments related to employer's operations
- Must affect the operations in a substantial manner
- Authority to implement, interpret, or create management policies or operating practices
- Authority to deviate from established policies or procedures without prior approval
- Employee may commit the employer in significant financial matters
- Involvement in planning of long- or short-term business objectives
- Conducts investigations or resolves matters for management
- Represents the employer in complaints or disputes



Administrative Exemption (cont.)

- **Salary Test**
 - \$455 per week?
 - Salaried?



Professional Exemption

■ Duty Test

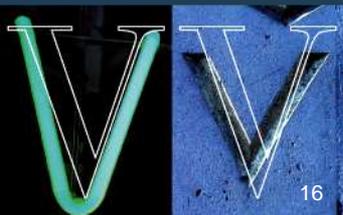
- The primary duty is the performance of work which requires either:
 1. Knowledge of an advance type or field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction; or
 2. Invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.

■ Salary Test

- \$455 per week?
- Salaried?

■ Two types of professional exemptions

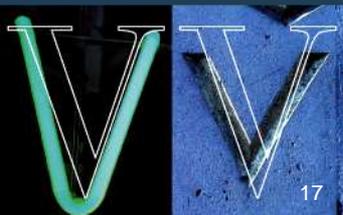
1. Learned Professional
2. Creative Professional



Professional Exemption (cont.)

■ Learned Professional

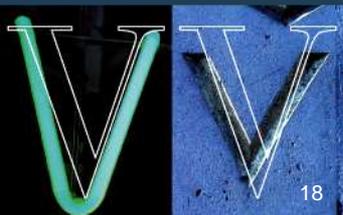
- The work must require advanced knowledge
 - Intellectual in character
 - Requires consistent discretion and independent judgment
 - Not routine mental, manual, or mechanical work
- Usually acquired through prolonged specialized study
 - Specialized degree or period of instruction
- Common examples
 - Lawyers
 - Doctors
 - Pharmacists
 - Registered Nurses
 - Physician Assistants
 - Chefs
 - Athletic Trainers



Professional Exemption (cont.)

■ Creative Professional

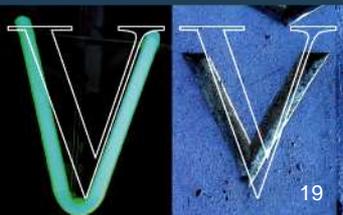
- The employee's primary duty must require invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor
 - Not routine mental, manual, or mechanical work
- A recognized field of artistic creative endeavor
 - Original and creative in character
 - Not mere reproduction by an employee with ability and training
 - E.g., music, writing, acting, graphic design



Computer Professional Exemption

■ Duty Test

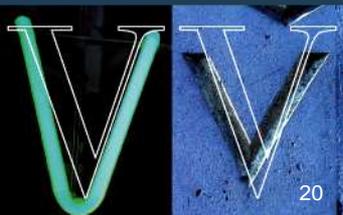
- The primary duty must consist of:
 - Application of systems analysis techniques and procedures, e.g., consulting with users to diagnose and fix IT problems;
 - Design, development, analysis, testing, or modification of computer systems or programs, e.g., creating prototypes or design specifications;
 - Design, testing, creation, or modification of computer programs related to machine operating systems; or
 - A combination of any of the above, so long as the duty requires the same skill level



Computer Professional Exemption (cont.)

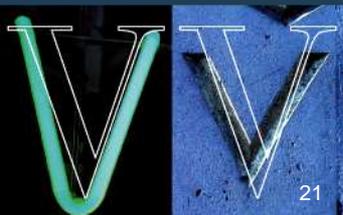
- **Salary Test**

- Unlike other exemptions, allows for hourly rate:
 - \$455 or more per week and on salary basis; or
 - \$27.63 or more per hour



Seasonal Employee Exemption

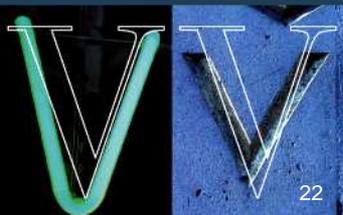
- **No Duty Test**
- **Employer-specific inquiry:**
 - Employer is an amusement or recreational establishment, organized camp, or religious or nonprofit educational center; and either
 - Employer does not operate for more than seven months in any calendar year; or
 - During the preceding year, the employer's average monthly receipts for any six months were not more than one-third of its average monthly receipts for the other six months of the same year.
 - “Any six months” means the employer can choose which six months of the year
 - May – October = \$260K = \$43,333 per month
 - November – April = \$75K = \$12,500 per month



Highly Compensated Employees Exemption

■ Requirements

- Annual compensation of at least \$100,000;
- Compensation includes at least \$455 per week in salary;
- The employee's primary duty includes performing office or non-manual work; and
- The employee customarily and regularly performs at least one of the exempt duties or responsibilities of an exempt, administrative, or professional employee.



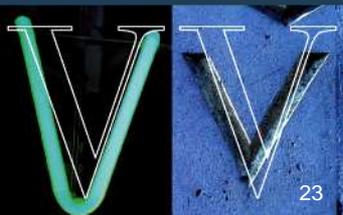
Salary Test Deductions

■ Permissible Deductions from Salary

- Absences for personal reasons, i.e., not sickness or disability
- Deductions for sickness or disability absences pursuant to a bona fide sick plan
- Penalties for major safety rule violations*
- Disciplinary suspensions for one or more full workdays

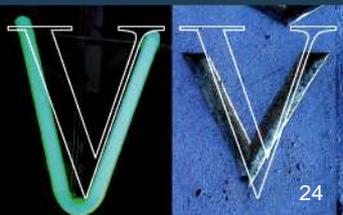
■ *State-by-State Payroll Deduction Rules

- In general, very strict civil penalties for deducting employees' pay
- E.g., payroll deductions for damaged property are typically illegal



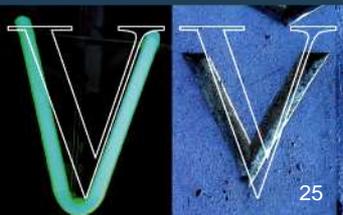
Salary Test Deductions (cont.)

- **Consequences of Impermissible Deductions**
 - “Actual Practice” of making improper deductions?
 - Number of improper deductions
 - Time period of improper deductions
 - Existence/absence of clearly communicated policy regarding improper deductions
 - If “actual practice”
 - Salary test is not satisfied for the time period in which the “actual practice” occurred for employees in the same job classification and working for the same managers responsible for the improper deductions
 - Affected employees will not be deemed to have earned \$455 per week



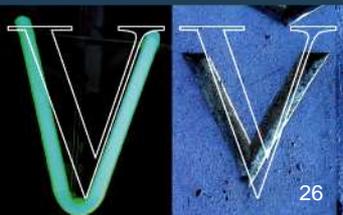
Salary Test Deductions (cont.)

- **Safe Harbor Provision**
 - No consequences for improper deductions if:
 - Clearly communicated policy prohibiting improper deductions, including internal complaint procedure;
 - The employer reimburses employees for improper deductions; and
 - The employer makes a good faith commitment towards future compliance.
 - No safe harbor available if the employer willfully makes improper deductions after notice, e.g., receipt of an employee complaint.



Independent Contractors

- **Employees v. Independent Contractors:**
 - *No one factor is dispositive!*
 - Written Agreement
 - Control: Behavioral & Financial
 - Relative Investments
 - Opportunity for Profit/Loss
 - Required Skill & Initiative
 - Permanency of Relationship
 - Separate Entity Question
 - Tax Forms & Benefits



Independent Contractors (cont.)

■ Three-Prong Test

1. Financial Control

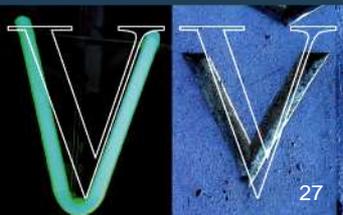
- Unreimbursed business expenses
- Worker's investment in the facilities or tools used in services
- Worker makes his or her services available to the relevant market
- How the business pays the worker
- The extent to which the worker can realize a profit or incur a loss

2. Behavioral Control

- Right to direct and control what work is accomplished
- How the work is done, through instructions, training, or other means

3. Type of Relationship

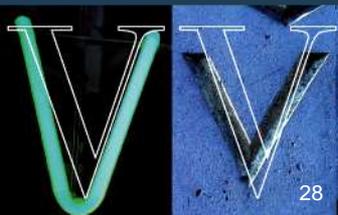
- Written contracts describing the relationship
- Employee benefits, e.g., insurance, pension, vacation, or sick pay
- The permanency of the relationship
- Are services performed by the worker a key aspect of the business?



Independent Contractors (cont.)

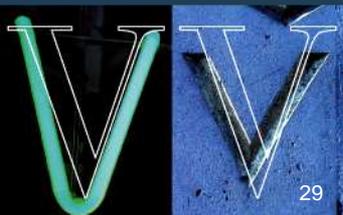
IRS 20 FACTOR TEST

| | | |
|------------------------------------------|---------------------------------------------|------------------------------------------|
| 1. Level of instruction | 2. Amount of training | 3. Degree of business integration |
| 4. Extent of personal services | 5. Control of assistants | 6. Continuity of relationship |
| 7. Flexibility of schedule | 8. Demands for full time work | 9. Need for on-site services |
| 10. Sequence of work | 11. Requirements for reports | 12. Method of payment |
| 13. Payment of expenses | 14. Provision of tools and materials | 15. Investment in facilities |
| 16. Realization of profit or loss | 17. Work for multiple companies | 18. Availability to public |
| 19. Control over discharge | 20. Right of termination | |



Ten Most Common Classification Pitfalls for Nonprofits

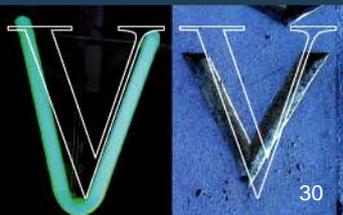
1. Always classifying salaried employees as exempt.
2. Always classifying supervisors as exempt.
3. Classifying exemptions based upon job descriptions or titles only.
4. Making deductions from exempt employees' paychecks.
5. Misperception that exempt employees may not be rewarded with weekly compensation beyond their salaries.
6. Classifying all employees who work with computers as computer professionals.
7. Always classifying commissioned employees as exempt.
8. Equating all jobs performed by all highly educated employees with exempt jobs.
9. The myths about independent contractors.
10. Paying exempt employees a full week's salary if work is performed for some, but not all, of the work week.



PITFALL # 1

Always classifying salaried employees as exempt.

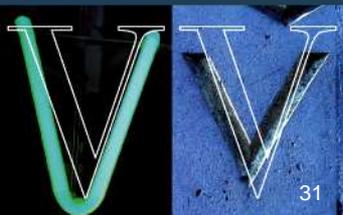
- **Salaried employees are not necessarily exempt.**
- **The salary test is only half of the equation.**
- **A salaried employee may not meet the duty test.**
- **Unless the duty test is met, the salaried employee must receive overtime pay.**
 - Calculation:
 - Determine weekly salary
 - Divide by hours weekly salary was intended to cover
 - Employee receives this hourly rate for every hour up to 40 that week
 - Multiply by 1.5 for hours worked above 40 per week
 - Special rules for fluctuating workweek



PITFALL # 2

Always classifying supervisors as exempt.

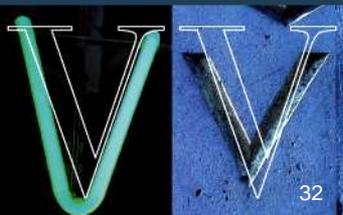
- Supervisors are not necessarily exempt.
- “Primary duty” is the key factor.
 - E.g., the “shift supervisor” who is a lead cashier
 - Is the employee’s primary duty the supervision of other employees?
 - What can the employee do to fire/hire other employees?
 - Is the employee more akin to a “lead foreman” who works alongside others or a manager who oversees a department?



PITFALL # 3

Classifying exemptions based upon job descriptions or titles only.

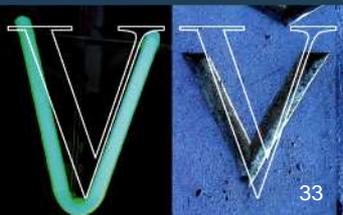
- Job descriptions are important, but are only a single factor.
- The DOL or a court will still look to the actual job duties performed.
- Job descriptions help prove an employer's reasonable expectations.
- Critical for disciplinary issues.



PITFALL # 4

Making deductions from exempt employees' paychecks.

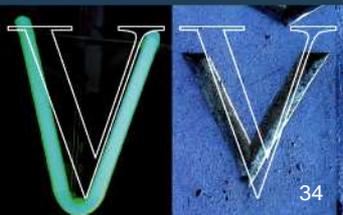
- Exempt employees must be paid a guaranteed base salary.
- The base salary cannot fluctuate from week to week.
- Common improper deductions from exempt employees' paychecks include:
 - Late arrivals or early departures
 - Poor quality of work
- Future pay cuts are OK.
- Need for clearly communicated policy.



PITFALL # 5

Misperception that exempt employees may not be rewarded weekly compensation beyond salaries.

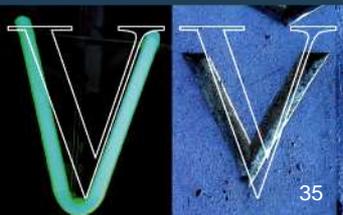
- Exempt employees must be paid a guaranteed base salary.
- As long as the base salary is paid, exempt employees may receive additional weekly compensation.
- Permissible weekly bonuses or additional payments for:
 - Sales figures
 - Productivity levels
 - Quality of work
 - Extended hours



PITFALL # 6

Classifying all employees who work with computers as computer professionals.

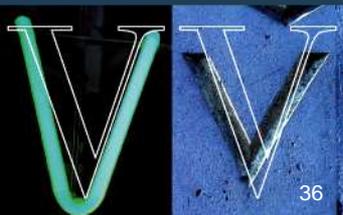
- **Commonly misclassified employees:**
 - Data entry employees
 - Computer hardware repair, manufacture, or maintenance employees
- **Employees may perform highly technical tasks, but at another's complete direction.**
- **Computer professional exemption more likely to become stale over time for specific employees.**



PITFALL # 7

Always classifying commissioned employees as exempt.

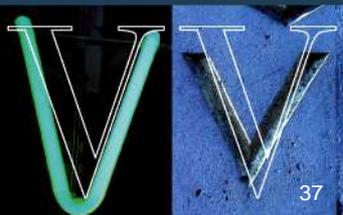
- **Outside salesperson**
 - Primary duty of making sales or obtaining orders or contracts for services or facilities use; and
 - Customarily engaged away from business establishment to perform exempt sales function
- **Commissioned salesperson**
 - Retail or service establishment; and
 - Rate of pay above 1½ times minimum wage
- **Common classification issues**
 - “Customarily” engaged away from the office?
 - “Retail or service establishment?”



PITFALL # 8

Equating all jobs performed by highly educated employees with exempt jobs.

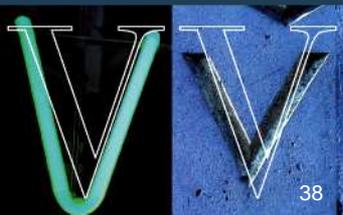
- **Why misleading?**
 - Some jobs require special degrees or prolonged course of study.
 - Some jobs also require use and application of highly complex and specialized knowledge.
- **The professional exemption still requires independent judgment and discretion.**
- **Red flag: if the employee merely follows prescribed procedures.**



PITFALL # 9

The myths about independent contractors.

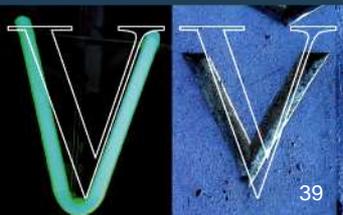
- Independence to perform his/her job is not dispositive.
- Wide variety of factors.
- Key questions:
 - May the independent contractor determine how to achieve the objective for which he/she was retained?
 - Does the independent contractor perform any of the same job functions as employees?
 - Does the independent contractor provide services that are otherwise unavailable to the employer?
 - Are the independent contractor's services integral to the employer's business enterprise?



PITFALL # 10

Paying exempt employees a full week's salary if work is performed for some, but not all, of the work week.

- **Common misperception:**
 - If an exempt employee works three out of five days in a workweek, the employer must pay the exempt employee for all five days because he/she is exempt.
- **“Ready, willing, and able” to work**
 - If the missed work days are due to lack of work, no pay deductions may be made.
 - Furloughs available, however.
- **Absences for personal reasons**
 - The employer may deduct an exempt employee's pay for absences due to personal reasons, among other things.



Questions

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