

# The Employer's Guide to Employee Classification & Wage and Hour Laws

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- HR training
- Creation of employee manuals
- Employment contracts
- Employment litigation

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# Background

The Wage and Hour Division (“WHD”) of the Department of Labor (“DOL”) enforces the provisions of the Fair Labor Standards Act (“FLSA”). The FLSA establishes minimum wage requirements, overtime requirements for non-exempt employees, record-keeping, and other standards affecting employees in the private sector and in federal, state, and local governments.

The DOL also has power to investigate compliance with other laws (OSHA, FMLA, etc.), but has in recent years increasingly focused its auditing and enforcement resources on FLSA claims.

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# Background

The FLSA requires that most employees in the United States be paid at least the federal minimum wage for all hours worked, and overtime pay at time and one-half (at the employee's regular rate of pay) for all hours worked over 40 hours in a workweek.

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# Background

## *Who is subject to the FLSA?*

- Almost all private and public employers (“engaged in commerce or production of goods for commerce”).
- Exempt versus non-exempt employees.
  - Specific types of employees exempt from FLSA’s provisions – more on this later.

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# Why the surge in lawsuits and audits?

In 2009, the Government Accountability Office was critical of the DOL for failing to thoroughly investigate claims.

In response, the DOL hired 350 more investigators and sought more money from Congress. Dept. of Labor Secretary Solis stated, “Make no mistake, the DOL is back in the enforcement business.”

2010: the DOL launched a public awareness campaign called “We Can Help” – designed to provide workers with information about their rights.

2011, the DOL unveiled a smartphone app – an electronic timesheet employees are encouraged to use to track their hours of work.

FY 2011: \$225 million in back wages for employees – a 28% increase from FY 2010. FY 2012: \$280 million in back wages for employees.

# Why the surge in lawsuits and audits?

In February, the President issued an Executive Order, requiring employees on federal service and construction contracts be paid no less than \$10.10 per hour, ordering the DOL to issue final regulations by October 1, 2014. In March 2014, President Obama instructed the Labor Secretary to come up with a plan that would expand the number of workers eligible for overtime pay.

Also in March, the White House released the President's budget request for FY2015. The U.S. Department of Labor's budget request includes more than **\$11.8 billion** in funding increases across all of its programs. The Wage & Hour Division would get \$41 million of that increase. This **18% increase** to WHD's budget seeks to allow it to add more than 300 new investigative positions and improve the technology used to target employers.

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# Exempt vs. Non-Exempt

Section 13(a)(1) of the FLSA exempts employees employed as bona fide executive, administrative, professional, or outside sales employees, as well as certain computer employees, from federal minimum wage and overtime compensation protection.

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# Exempt vs. Non-Exempt

In determining an employee's status, you must evaluate (1) their salary level, and (2) job duties.

Exempt salary requirements:

- \$455 per week (\$910 bi-weekly; \$1,971.66 monthly; \$23,600 annually).
- The amount cannot be reduced because of variations in the **quality or quantity** of the employees work.
- 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 (with a few exceptions).

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# Exempt vs. Non-Exempt

## *Executive Employees:*

- Executive employees must make at least \$455 per 40-hour work week.
- Their primary duties must consist of management of the enterprise in which the employee is employed or a recognized department or subdivision of that enterprise.
- They must regularly direct the work of two or more other employees.
- They must also have the authority to hire and fire, or have significant influence over the hiring and firing process.

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# Exempt vs. Non-Exempt

## *Administrative Employees:*

- Administrative employees must make at least \$455 per 40-hour work week.
- Their primary duties must consist of office or non-manual work directly related to the management policies or general business operations of the employer or the employer's customers.
- Their job must require them to exercise discretion and independent judgment over significant matters.

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# Exempt vs. Non-Exempt

## *Professionals:*

- Professional employees must make at least \$455 per 40-hour work week.
- Their primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment.
- The advanced knowledge must be in a field of science or learning; and
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

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# Exempt vs. Non-Exempt

## *Creative Professionals:*

- Professional employees must make at least \$455 per 40-hour work week.
- The employee's primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

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# Exempt vs. Non-Exempt

## *Highly Compensated Employees:*

- Must perform office or non-manual work and be paid total annual compensation of \$100,000 or more (which must include at least \$455 per week paid on a salary or fee basis).
- Customarily and regularly perform at least one of the duties of an exempt executive, administrative or professional employee identified in the standard tests for exemption.

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# Exempt vs. Non-Exempt

## *Computer Employees:*

- Computer employees must make at least \$455 per 40-hour work week or be paid at least \$27.63 per hour.
- They must apply system analysis techniques and procedures including consulting with users to determine hardware, software, or system functional specifications and design, development, documentation, analysis, creation, testing, or modification of computer systems or programs.

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# Exempt vs. Non-Exempt

## *Outside Sales Employees:*

- The employee's primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- The employee must be customarily and regularly engaged away from the employer's place or places of business.
- The salary requirements of the regulation do not apply to the outside sales exemption.

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# Independent Contractors

Many employers choose to classify certain workers as independent contractors rather than employees. Some of the potential benefits of this classification decision include: avoiding payroll-related administrative costs; avoiding fringe benefit obligations; avoiding employment taxes; avoiding worker's compensation liabilities and costs; avoiding unionization; avoiding paying overtime compensation; and establishing a short-term, readily terminable relationship with workers.

However, as many businesses are now experiencing firsthand, independent contractor arrangements are coming under increased scrutiny by state and federal government agencies and are the subject of a growing number of class action lawsuits.

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# Independent Contractors

There is no universal test for determining whether a worker is an independent contractor. In fact, agencies and courts use many different tests depending on which law is involved. A worker who may be considered an independent contractor under the IRS Code may not be considered an independent contractor under the FLSA.

Determining whether a worker is an independent contractor requires a fact-intensive inquiry into the duties of the specific worker. The parties' designation of a worker as an independent contractor, **even if agreed upon**, is not dispositive.

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# Independent Contractors

In determining whether a worker is an employee or an independent contractor, the IRS compares the degree of control exerted by the company to the degree of independence retained by the individual. Generally, the IRS examines this relationship in three ways:

**Behavioral:** Does the company control or have the right to control what the worker does and how the worker does his or her job?

**Financial:** Are the business aspects of the worker's job controlled by the payer? (these include things like how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)

**Type of Relationship:** Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

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# Independent Contractors

## *The 20 Factors*

**Instructions.** A worker who must obey the company's instructions about how the job is to be performed is usually found to be an employee of the company.

**Training.** The company should not have to train the independent contractor.

**Integration.** "Integration" refers to how closely related the work of the company is to the work of the worker. The closer the relationship between the work of the company and the work of the worker, the more likely the worker is an employee.

**Services Rendered Personally.** If the company demands the worker personally perform the services, then this shows control by the company over the worker which makes it more likely that the worker is an employee.

# Independent Contractors

## *The 20 Factors*

**Hiring, Supervising and Paying Assistants.** When the company hires, supervises and pays the worker's assistants, this shows control by the company over the worker (and makes it more likely the worker is an employee).

**Continuing Relationship.** The pressure of a continuing relationship between the worker and the company tends to show an employer-employee relationship.

**Set Hours of Work.** A hallmark of independent contractor status is the total freedom to plan one's own workday.

**Full Time Required.** As an independent contractor, the worker should be free to accept or reject any job offered by the company.

**Doing Work on Company's Premises.** An independent contractor should possess his or her own place of business.

# Independent Contractors

## *The 20 Factors*

**Order or Sequence Set.** As an independent contractor, the worker should set the work schedule.

**Oral or Written Reports.** Employees are often required by employers to hand in reports, which are viewed by the IRS as evidence of control.

**Payment by Hour, Week or Month.** Payment to independent contractors should be by the job rather than by the hour, day, etc.

**Payment of Business and/or Traveling Expenses.** An independent contractor should pay for all of his or her own overhead.

**Furnishing of Tools and Materials.** If a company covers the cost of the worker's supplies, tools, and equipment, independent contractor status is weakened.

**Significant Investment.** The larger the worker's investment in his or her own business, the more likely it is that the worker is an independent contractor.

# Independent Contractors

## *The 20 Factors*

**Realization of Profit or Loss.** An independent contractor should be capable of either realizing a profit or suffering a loss.

**Working for More than One Company at a Time.** While a worker can perform services for several companies and still be classified as an employee for one or all of them, independent contractor status is strengthened if the worker has a diverse and significant client base.

**Making Services Available to the General Public.** As an entrepreneur, an independent contractor should hold his or her name out to the general public.

**Right to Discharge.** While an employer may discharge an employee, parties to an independent contractor agreement have an obligation to terminate their contract with some type of notice requirements.

**Right to Terminate.** When a worker can terminate his or her relationship with the company at any time without incurring liability, it is suggestive of an employee-at-will relationship. An independent contractor cannot simply walk away from his or her contractual relationship to the company.



# Independent Contractors

## *FLSA's Six-Part "Economic Realities Test"*

The U.S. Supreme Court has on a number of occasions indicated that there is no single rule or test for determining whether an individual is an independent contractor or an employee for purposes of the FLSA. The Court has held that it is the total activity or situation which controls. The Court considers these factors significant:

- 1) The extent to which the services rendered are an integral part of the principal's business.
- 2) The permanency of the relationship.
- 3) The amount of the alleged contractor's investment in facilities and equipment.
- 4) The nature and degree of control by the principal.
- 5) The alleged contractor's opportunities for profit and loss.
- 6) The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
- 7) The degree of independent business organization and operation.

# Independent Contractors

## *Kentucky's Four-Part Test*

The Kentucky Supreme Court addressed this distinction in *UEF v. Garland*, 805 S.W.2d 116 (Ky. 1991), setting out a four factor test. The factors are:

- 1) Nature of the work as related to the business generally carried on by the alleged employer;
- 2) Extent of control exercised by the alleged employer;
- 3) Professional skill of alleged employee; and
- 4) The true intent of the parties.

# Independent Contractors

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# The DOL at Your Door

## *What triggers an audit?*

- A complaint
- A “directed investigation”
- Random selection
- Follow-up to previous investigation

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# The DOL at Your Door

*What does an investigation look like?*

- Selection of company/business
- Initial contact
- Document requests (payroll, tax records, written policies and procedures)
- Onsite inspection and employee interviews
- Closing conference
- *Litigation?*

*Employers may be represented by their accountants or attorneys at any point during this process!*

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# The DOL at Your Door

## *The initial conference*

The investigator will clarify the scope of the DOL investigation. Remember that an investigator does not have to disclose what prompted the investigation, and that complaints are confidential. During this stage, management may be asked questions about their daily operations, revenue, payment methods, and other employment issues. It is during this time that employers should discuss with the investigator how interviews or document production will be handled in the investigation.

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# The DOL at Your Door

## *Document production*

Keep a record of all documents produced. If the investigator asks for information that includes trade secrets or proprietary information, be sure to properly label the documents as such.

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## *On-site inspection*

The investigator may want to take a look around the facility or office. The investigator may speak with employees and take notes. The employer may accompany the investigator while he or she is on-site.

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# The DOL at Your Door

## *Employee interviews*

The DOL may conduct interviews of individual employees. Employees should never be coaxed or coerced about what to say in an interview, but they can be prepared. Legal counsel can educate employees on what to expect, inform them that interviews are voluntary, and that they have certain rights in the course of the interview (such as demanding a copy of any written statements or examining documents that are in discussion).

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# The DOL at Your Door

## *Closing conference*

If the investigator finds that violations have occurred, a closing conference will be conducted. Such a conference may be held weeks after the on-site inspection. At the closing conference, the DOL findings are communicated, the actions necessary for compliance are established, and post-audit rights are explained. Employers may ask for additional time to provide information to correct any factual errors that the investigator found.

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# Best Practices for Exempt/Non-Exempt

*Watch out for these common pitfalls:*

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 employees —if you're requiring an employee to answer phones or perform *any task* during lunch you have not provided a true lunch break.

# Best Practices for Exempt/Non-Exempt

*Watch out for these common pitfalls:*

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).

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.

Thinking that the non-exempt status can be voluntarily waived by the employed.

# Best Practices for Exempt/Non-Exempt

Examine very closely all written job descriptions to ensure that they: (i) accurately reflect the work done, (ii) have been updated where necessary, and (iii) indeed justify the applicable exemptions.

Review time keeping systems to ensure that non-exempt employees are being paid for all work performed

Do not automatically deduct time for employee meals or breaks without verifying whether they were taken.

Develop a formal program for reporting and resolving employee wage concerns.

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# Best Practices for Independent Contractors

Enter into employment contract before work begins.

- Establish tasks to be performed and results to be obtained, but avoid exerting too much control (where work must be done, working hours, requiring weekly reports, etc.).
- Clearly label it an “Independent Contractor Agreement” and specify that the employer will not be liable for payroll taxes, health benefits, etc.
- Do not limit the independent contractor’s ability to accept work from other businesses.

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# Best Practices for DOL Audits

Be calm, courteous and respectful toward the DOL investigators.

Designate one person to handle the investigation and serve as the company's designated contact with the investigator.

Immediately contact HR, managers and supervisors, IT, legal and accounting to inform them of the pending audit.

Follow up in writing on any conversations you have with investigators.

# Best Practices for DOL Audits

Always review information before handing it over to the investigator.

Request the 72-hour time frame if so needed to review and compile documents.

Assign a work space for the investigator and provide a private space for employee interviews.

*Train staff about overtime basics.*

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*Self-audit often!* **( M C B R A Y E R )**

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