

Classification of Employees as Exempt v. Non-Exempt Under the Fair Labor Standards Act

By Maureen E. Carr, Esq.

The Fair Labor Standards Act (“FLSA”) is a wide-reaching employment law that establishes federal minimum wage, overtime pay, equal pay, recordkeeping, and child labor standards, and establishes an important distinction between (1) exempt (a.k.a. salaried) workers, who are exempt from the minimum wage and overtime requirements of the FLSA, and (2) non-exempt (hourly) workers, who are not exempt from such requirements.

The FLSA applies to most private sector employees by way of (1) enterprise coverage, where the employer has two or more employees engaged in interstate commerce and annual gross sales of at least \$500,000; or (2) individual coverage, where an individual employee engages in interstate commerce even if the employer does not meet the requirements for enterprise coverage. In addition, the FLSA generally applies to government employees except non-civilian military personnel, with some exceptions and variances.

The most common FLSA exemptions (a.k.a. “white collar exemptions”) are executive, administrative, professional, computer, and outside sales, most of which have two requirements. First, the employee must be paid on a “salary basis,” meaning that the employee regularly receives a predetermined amount of compensation each pay period (at least \$455 per week¹) that is not subject to reduction because of variations in the quality or quantity of work performed, with limited exceptions. Second, the employee must meet the “duties test” for the specific exemption sought, meaning that the employee must regularly and customarily perform certain types of duties.

To qualify for the *executive exemption*, an employee must either (1) be highly compensated, meaning the employee’s total annual compensation is at least \$100,000 per year, and perform at least one duty of the standard test; or (2) meet the three-part standard test: (a) management is the employee’s primary duty; (b) the employee regularly and customarily directs the work of at least two full-time (or equivalent) employees; and (c) the employee has the authority to hire and fire employees (or significant input regarding such decisions).² As a general rule, this exemption is reserved for high level employees who are responsible for the success or failure of the business operations under their management, such as executives and bona fide managers and supervisors.

There are also two ways for an employee to qualify for the *administrative exemption*: (1) be highly compensated (annual compensation of at least \$100,000) and perform at least one duty of the standard test; or (2) meet the two-part standard test: (a) the employee’s primary duty includes office/non-manual work directly related to the management or general business operations of the employer or the employer’s customer (i.e. tax, finance, accounting, auditing,

¹ This dollar figure was set in 2004 and is likely to be increased as part of the Obama Administration’s efforts to reform overtime rules.

² The Obama Administration recently directed the Department of Labor to revamp its regulations to limit the applicability of the executive exemption.

quality control, purchasing, procurement, advertising, marketing, research, human resources, public relations); and (b) the employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance (i.e. employee creates or implements management/operating policies, controls operations, has authority to commit significant financial resources, and/or has authority to bind employer). Examples of employees who qualify for the administrative exemption include financial services employees, human resource managers, and accounting managers.

There are two distinct categories within the **professional exemption**: learned and creative. To qualify, an employee must either (1) be highly compensated (annual compensation of at least \$100,000) and perform at least one duty of the standard test; or (2) meet the standard test. To satisfy the standard test for a **learned professional**, an employee must have a primary duty that (a) meets three requirements: (i) must perform work requiring knowledge of an advanced type; (ii) the advanced knowledge must be in a field of science or learning (i.e. law, medicine, theology, accounting, actuary, engineering, architecture, teaching, pharmacy, science); and (iii) the advanced knowledge must customarily be acquired by a prolonged course of specialized intellectual instruction; and (b) involves the consistent exercise of discretion and judgment. The standard test for a **creative professional** requires an employee to have a primary duty that involves the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic/creative endeavor (i.e. music, writing, acting, graphic arts), as opposed to routine mental, manual, mechanical, or physical work. Examples include doctors, registered nurses, lawyers, teachers, and accountants (under the learned professional exemption), and writers, actors, and chefs (under the creative professional exemption).

There is only one requirement for the **computer exemption**: an employee must have a primary duty that consists of (a) the application of systems analysis techniques and procedures to determine hardware, software, or system functional specifics; (b) the design, development, documentation, analysis, creation, testing or modification of computer systems or programs based on and related to user or system design specifications; (c) the design, documentation, testing, creation or modification of computer programs related to machine operating systems; or (d) a combination of the above. Notably (and in contrast to certain other exemptions), the computer exemption does not require the exercise of discretion and judgment, cannot be obtained based solely on a high level of compensation, and allows for an hourly rate of pay (of at least \$27.63/hour). This exemption generally applies to high-level computer employees, not IT help desk personnel.

There are two requirements to qualify for the **outside sales exemption**: (1) the employee's primary duty must be making sales or obtaining orders/contracts for goods/services; and (2) the employee must be customarily and regularly engaged away from the employer's place of business while performing his primary duty. Like the computer exemption, this exemption does not require the exercise of discretion and judgment, and cannot be obtained based solely on a high level of compensation.

The chart on the following page *generally* summarizes and compares the five "white-collar" exemptions to the FLSA.

“White Collar” Exemptions to FLSA

	Salary basis	Alternative compensation structure	“Highly compensated” option	Standard test	Requires discretion & judgment
Executive	x		x	Duties: (a) management must be primary duty; (b) must supervise 2+ employees; <i>and</i> (c) must have authority to hire/fire	
Administrative	x (generally)	x (fee)	x	Primary duty includes office/non-manual work directly related to management or general business operations of employer or customers	x
Professional	x (creative)	x (fee – professional)	x	Learned: duties test: (a) must perform work requiring advanced knowledge; (b) in field of science or learning; <i>and</i> (c) acquired through prolonged course of specialized intellectual instruction	x (learned)
				Creative: primary duty must involve performance of work requiring invention, imagination, originality, or talent in recognized field of artistic/creative endeavor	
Computer	(hourly rate ≥\$27.63 allowed)	x (≥\$27.63)		Duties test: (a) application of systems analysis techniques and procedures to determine hardware, software, or system functional specifications; (b) design, development, documentation, analysis, creation, testing, or modification of computer systems or programs based on and related to user or system design specifications; (c) design, documentation, testing, creation, or modification of computer programs re: machine operating systems; <i>or</i> (d) combination of above	
Outside Sales	(no minimum compensation required)	x (i.e. commission)		(a) primary duty must be making or obtaining orders/contracts for goods/services (b) customarily and regularly engaged away from employer’s place of business	

The ramifications of improperly classifying employees as exempt under the FLSA can be significant. First, an employer may be the subject of a DOL investigation, which can result from an employee complaint or be conducted as part of a targeted industry investigation.³ Second, an employer may be sued by an employee (or employees) for back wages, liquidated damages (also known as “double back pay”), and attorneys’ fees, or by the DOL on behalf of an employee (or employees) for back pay and liquidated damages *or* back wages and injunctive relief preventing further violations. Notably, personal liability may be imposed on the employer’s officers, directors, and/or those employees who are “responsible” for the violation (based on an “economic reality” test). Third, criminal prosecution is possible for “willful” FLSA violations. Finally, the DOL can impose civil money penalties on employers.

The following are common classification mistakes:

- Classifying all “salaried” employees as exempt without regard to the employees’ duties → An employer cannot make an employee exempt simply by paying the employee a salary as opposed to an hourly rate. It is imperative that the employer evaluate the employee’s duties in relation to the “duties test” of each of the white-collar exemptions.
- Classifying all “supervisors” or “managers” as exempt → It is important to remember that the executive exemption does not automatically apply to all employees with management responsibilities. Rather, to qualify for the executive exemption, an employee must have management as his *primary* duty, regularly and customarily direct the work of at least *two* full-time (or equivalent) employees, and have the *authority to hire and fire* employees (or significant input regarding such decisions).
- Classifying based on job titles and descriptions alone → While job titles and descriptions can be helpful in evaluating exemption status, each employee must be evaluated on a case-by-case basis to determine whether the employee is exempt.
- Classifying all highly educated employees as exempt → While it is tempting to classify all highly educated employees as exempt, that approach ignores the employee’s actual duties, which will often be the determining factor in evaluating exempt status.
- Classifying all employees as exempt because the employer provides professional services or pays employees above the market rate → Again, this approach can be enticing, but it is imperative that each employee be evaluated on a case-by-case basis.

³ DOL wage and hour investigations have increased under the Obama Administration, particularly with respect to industries such as construction, hospitality, janitorial, home health care, child care, transportation, warehousing, and meal/poultry processing.

Finally, there are several tips to follow to ensure the proper classification of employees as exempt or non-exempt. First and foremost, evaluate each employee individually. Second, do not rely on job titles and/or descriptions alone. Third, do not assume that all workers with the same title or at the same level should be classified the same. Fourth, consult the DOL Fact Sheets for exemptions: <http://www.dol.gov/whd/fact-sheets-index.htm>. Fifth, utilize the DOL's Overtime Security Advisor: <http://www.dol.gov/elaws/esa/flsa/overtime/menu.htm>. Finally, consult your attorney to conduct a thorough analysis of classifications.⁴

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⁴ It is important to note that the classification of employees as exempt or non-exempt under the FLSA can be quite complicated, and there are exceptions to many of the general rules synopsized in this article. Therefore, it is advisable to consult with your counsel when evaluating such classifications.