



**Are you correctly classifying
your employees?**

Hourly or salaried, exempt or nonexempt:

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When it comes to managing your employee classifications, if you're a little confused, you aren't alone. According to [Troutman Sanders LLP](#), incorrectly classifying an employee as exempt is considered the *biggest* mistake you can make when it comes to the Fair Labor Standards Act (FLSA).

So how do you know what the correct classification for an employee is? This guide will help you understand if a worker is exempt or nonexempt as defined by FLSA and prepare you for the changes coming in December 2016.

Using this guide, you can:

- Audit your classifications and do your due diligence to make sure you're in good shape.
- Learn the difference between exempt and nonexempt.
- Understand why correct exemption status classification matters.
- Learn the proposed rule change to the FLSA "white collar" exemption and find out how it may affect your company.

Exempt Or Nonexempt: The Basics

From the [Department of Labor Wage and Hour Division](#):

The FLSA establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in Federal, State, and local governments. Covered nonexempt workers are entitled to a minimum wage of not less than \$7.25 per hour effective July 24, 2009. Overtime pay at a rate not less than one and one-half times the regular rate of pay is required after 40 hours of work in a workweek.

Determining whether your employees have exempt or nonexempt status is not always straightforward. Exempt or nonexempt status refers to an employee's eligibility for overtime pay and certain other legal rights. You may commonly hear them referred to as salaried (exempt) or hourly (nonexempt) workers. Here's a basic breakdown of [exempt vs. nonexempt](#):

Nonexempt: A nonexempt employee needs to be paid at least minimum wage and must be paid overtime (1.5 times regular rate) for all hours above 40 in a workweek. Most U.S. workers fall into this class unless they meet certain requirements to make them exempt.

Exempt: An exempt employee is not protected by FLSA and employers are not required to pay overtime wages for any work above 40 hours per week. (The term "exempt" literally means exempted from FLSA.) Exempt employees need to meet the following criteria:

- They must be paid at least \$23,600 per year (\$455 per week).
- They must be paid on a salary basis.
- They must perform duties that are considered exempt.

There are three main categories of [exempt duties](#):

- Executive
- Professional
- Administrative

Note: There is a salaried nonexempt category for workers who are guaranteed salary, but if those employees work more than 40 hours, they are paid time-and-a-half for their hours. However, for the purposes of this guide, we will not be including this category.

Why does correct exemption status classification matter?

Classification is an area that many businesses get wrong. Making sure your employees are properly classified protects you from the potentially damaging repercussions of an audit. If you're audited and found in violation of FLSA guidelines, you may be forced to pay steep penalties. By taking the time to determine the correct status of your employees, you will save yourself valuable time and money (and headaches).

We recommend the best practice of documenting each of the factors used to determine how you came to each classification decision. The supporting documentation will be useful if a classification is ever called into question.

Even though this may not affect your company right now, the changes coming to FLSA on December 1, 2016 will affect you soon. Here's what you need to review in advance so you can prepare:

1. Review the salaries of your exempt-level staff against the proposed salary changes.
2. Review the job descriptions of your exempt-level staff to ensure they meet the duties test.
3. Determine whether any changes to salary or duties will be required to maintain the exemption.
4. Make a plan for changing the classification at the appropriate time.

Changes Coming on December 1, 2016

The FLSA “Final Rule” to modify the white collar exemptions provided by the FLSA will go into effect on December 1, 2016. The white collar exemptions are minimum wage and overtime exception rules for executive, administrative, professional, outside sales, and computer employees.

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Key Provisions of the Final Rule

The Final Rule focuses primarily on updating the salary and compensation levels needed for Executive, Administrative and Professional workers to be exempt. Specifically, the Final Rule:

1. Sets the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region, currently the South (\$913 per week; \$47,476 annually for a full-year worker);
2. Sets the total annual compensation requirement for highly compensated employees (HCE) subject to a minimal duties test to the annual equivalent of the 90th percentile of full-time salaried workers

nationally (\$134,004); and

3. Establishes a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles and to ensure that they continue to provide useful and effective tests for exemption.

Additionally, the Final Rule amends the salary basis test to allow employers to use non-discretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level.

The effective date of the final rule is December 1, 2016. The initial increases to the standard salary level (from \$455 to \$913 per week) and HCE total annual compensation requirement (from \$100,000 to \$134,004 per year) will be effective on that date. Future automatic updates to those thresholds will occur every three years, beginning on January 1, 2020. ([Department of Labor](#))

Why is the DOL issuing a proposed rule?

In 2015, President Barack Obama directed the DOL to simplify and modernize the regulations that protect white collar workers under the FLSA. The administration's concern is that current white collar exemption requirements are outdated, since the salary threshold has been changed only twice in the last 40 years. Fewer workers are eligible for overtime now than in the past due to inflation.

Impact On Employers

The proposed rule would require employers to redetermine the exemption status of employees, update and adapt overtime policies, notify employees of policy changes, and adjust their payroll systems. These measures could trigger significant costs. For example, employers may be required to pay overtime wages to previously exempt employees. On the other hand, the DOL is predicting that higher salary level requirements for white collar exemptions will simplify the process of employee classification because employers would not be required to perform a duties test for employees below the updated salary requirements. This simplification could result in fewer lawsuits and lower litigation costs for employers.

Exemptions

FLSA requires that nonexempt employees in the United States be paid at least the federal minimum wage for all hours worked and overtime pay at time-and-a-half the regular rate of pay for all hours worked over 40 in a workweek.

However, Section 13(a)(1) of the FLSA provides an exemption from both minimum wage and overtime pay for white collar exemptions. These include exemptions for employees in the following categories:

Types Of Exemptions

- [Executive Exemption](#)
- [Administrative Exemption](#)
- [Computer Professional Exemption](#)
- [Outside Sales Exemption](#)
- [Professional Exemption](#)
- [Highly Compensated Employees](#)

Job titles alone do not determine exempt status. In fact, the job description is a key document for determining FLSA status. Therefore, organizations need to keep their job descriptions up to date to ensure that they accurately reflect job duties.

To qualify for the white collar exemption in any category, an employee must meet a [salary basis test, a salary level test, and a duties test.](#)

Permissible Deductions

Exempt workers generally must receive a full week's pay for a week in which they work, regardless of the number of days or hours worked, unless certain federal provisions are met. These can be [state-specific variations](#) as to what employers can deduct. For example, Massachusetts has the following exceptions:

- An absence from work for one or more full days for personal reasons, other than sickness or disability.
- An absence from work for one or more full days due to sickness or disability if deductions are made under a bona fide plan, policy, or practice of providing wage replacement benefits for these types of absences.
- To offset any amounts received as payment for jury fees, witness fees, or military pay.
- Penalties imposed in good faith for violating safety rules of "major significance," such as "no smoking" rules in explosive plants, oil refineries, and coal mines.
- Unpaid disciplinary suspension of one or more full days imposed in good faith for violations of workplace conduct rules, such as rules prohibiting workplace violence.
- A portion of an employee's full salary may be paid for time actually worked in the first and last weeks of employment.
- The employee takes leave under the Family Medical Leave Act.

Resources

- The [FLSA Exemption Test Questionnaire](#) will help you assess the appropriate exempt/nonexempt status of your employees. *Please note that an employee must meet the salary basis test to be exempt under the FLSA. If the person in the position earns less than the minimum required salary, the position is considered nonexempt and is subject to the overtime provisions of the FLSA.*
- [Request an opinion](#) from the Department of Labor.
- The [Coverage and Employment Status Advisor](#) can help you identify which workers are employees covered by the FLSA.
- For additional information regarding FLSA regulations and requirements, visit the [Department of Labor Wage and Hour Division website](#).

Want to learn more about how a PEO can help you navigate FLSA and all of your human resources, payroll, and employee benefits needs?

Let's talk.